

UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF NEW YORK

Case No. 08-13555(JMP)

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In the Matter of:

LEHMAN BROTHERS HOLDINGS, INC., et al.

Debtors.

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United States Bankruptcy Court

One Bowling Green

New York, New York

November 19, 2009

2:06 PM

B E F O R E:

HON. JAMES M. PECK

U.S. BANKRUPTCY JUDGE

1
2 HEARING re Lehman Brothers Special Financing Inc. v. BNY
3 Corporate Trustee Services Limited [Adversary Case No. 09-
4 01242]; Motions for Summary Judgment

5
6 HEARING re Debtors' Motion to Compel Performance of Chicago
7 Board. of Education's Obligations under Executory Contract to
8 Enforce Automatic Stay

9
10 HEARING re Chicago Board of Education v. Lehman Brothers
11 Special Financing Inc. [Adversary Case No. 09-01455]; Lehman
12 Brothers Special Financing Inc.'s Motion to Dismiss

13
14 HEARING re Neuberger Berman v. PNC Bank, NA, et al. [Adversary
15 Case No. 09-01258]; Motion to Deposit Funds and Motion to
16 Dismiss Case

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25 Transcribed by: Lisa Bar-Leib

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1 P R O C E E D I N G S

2 THE COURT: Be seated, please. Good afternoon, Mr.
3 Miller.

4 MR. MILLER: Good afternoon, Your Honor. I'm Ralph
5 Miller with Weil Gotshal & Manges here for the debtors
6 including Lehman Brothers Special Financing Inc, known as LBSF,
7 the plaintiff in the first matter on the agenda, which is
8 Adversary No. 09-1242. My colleague, Meredith Parenti, is
9 going to be appearing with me today on this matter.

10 Your Honor, if it's acceptable to you, we propose to
11 begin with short arguments in support of the LBSF motion for
12 summary judgment because that motion was filed first by the
13 plaintiff and we would like to share that argument with the
14 committee.

15 THE COURT: That's fine.

16 MR. MILLER: May it please the Court, the undisputed
17 facts, United States bankruptcy law and the record before this
18 Court require a summary judgment for LBSF declaring that
19 certain clauses in the transaction documents are unenforceable
20 ipso facto provisions. Despite arguments to the contrary by
21 defendant, BNY, nothing in the Perpetual Trustee case in London
22 should have any effect on that ruling.

23 I'd like to cover three major topics briefly to try
24 to put together the material in this voluminous record in a
25 focused way. First, I'd like to explain the key undisputed

1 facts showing violation of the ipso facto doctrine under United
2 States bankruptcy law by condition 44, clause 5.5 and related
3 provisions implementing them in the transaction documents.

4 Next, I'll talk about the opposition to LBSF summary
5 judgment by BNY which is largely based on rulings in the
6 Perpetual trustee case in London in comity arguments related to
7 that case.

8 First, in that regard, the Court received yesterday a
9 letter from Mr. Justice Henderson of the High Court which makes
10 it clear that there is no objection by that Court if you so
11 find to a declaratory judgment to the effect that the relevant
12 provisions are void or otherwise unenforceable under U.S.
13 bankruptcy law. In paragraph 15 of the transcript of the oral
14 ruling, which was attached to that letter, Mr. Justice
15 Henderson stated that he agreed with the proposition, as you
16 had observed, Your Honor, that "the only rational outcome that
17 makes good sense in a cross-border setting is for the United
18 States bankruptcy court to be the principal, if not exclusive,
19 decider of issues relating to U.S. bankruptcy law."

20 As I will discuss more in a minute, Your Honor knows
21 that the English court was dealing with the so-called
22 deprivation principle under English common law which, despite
23 some facial resemblance to the ipso facto doctrine under U.S.
24 statutes, is based on a very different concept of property
25 rights than those reflected in Section 541 of the Bankruptcy

1 Code. For that reason and for others related to international
2 application of res judicata and comity, the rulings in the
3 London High Court have no bearing on the U.S. bankruptcy law.

4 When the documents in these transactions are examined
5 under Section 365 and 541 of the U.S. Bankruptcy Code, it's
6 clear that a post-bankruptcy modification of the property
7 rights of LBSF would be caused by condition 44 and clause 5.5
8 and other implementing provisions. And that modification is
9 prohibited by the ipso facto doctrine.

10 The third topic I'll cover briefly, which has been
11 extensively briefed, is the purported application of various
12 safe harbors. May we approach and pass out some notebooks with
13 some excerpts from the record and some visual aids, Your Honor?

14 THE COURT: Yes, absolutely.

15 (Pause)

16 THE COURT: Thank you.

17 MR. MILLER: Turning to the facts, Your Honor, all
18 the parties agree that timing is critical to this analysis, so
19 we wanted to start with a simplified timeline that summarizes
20 key points in this voluminous record. This is tab 1 in the
21 notebooks.

22 The first critical fact, which was not addressed
23 squarely in any of the English opinions, is that the disputed
24 provisions do not become effective until a termination has been
25 noticed. And that did not happen until December 1, 2008,

1 almost two months after LBSF filed Chapter 11 protection on
2 October 3, 2008.

3 If you'll turn to tab 2, that contains copies of the
4 early termination notices which are Exhibits H and I to the
5 Alana Lee (ph.) declaration in the record. These were both
6 sent on December 1 and they're both key only to the Chapter 11
7 filing of LBSF. First, the Court will note in the redline that
8 there is a definition of the word "Lehman" as Lehman Brothers
9 Special Financing Inc., the plaintiff in this case. And then
10 if you go down to the second major paragraph, it says "On 3
11 October, 2008, Lehman filed a voluntary petition for relief
12 under Chapter 11 of Title 11 of the United States Code.
13 Pursuant to Section 5(a)(7) (Bankruptcy) of the ISDA Master
14 Agreement, this Chapter 11 filing by Lehman constitutes an
15 event of default under the ISDA Master Agreement with respect
16 to Lehman. This letter constitutes formal written notice of
17 the existence of an event of default under the ISDA Master
18 Agreement. The issuer as the non-defaulting party in
19 accordance with Section 6(a) of the ISDA Master Agreement
20 hereby designates 1 December, 2008 as the early termination
21 date under the ISDA Master Agreement for the transaction."

22 Now, there are two transactions in issue here. The
23 other one has a virtually identical termination notice which is
24 also attached after the colored piece of paper in tab 2.

25 Tab 3, Your Honor, is a familiar document to the

1 Court. This is two pages from the ISDA Master, the cover and
2 in the second page has Section 6(a) which we have talked about
3 in other cases. And as the Court recalls, there are two ways
4 that Section 6(a) can be set up. It can have an automatic
5 provision which is at the bottom. That was not applicable
6 here. Otherwise, it provides that "if at any time an event of
7 default with respect to a party, the non -- the defaulting
8 party, has occurred and is then continuing the other party, the
9 non-defaulting party, may, by not more than twenty days' notice
10 to defaulting party specifying the relevant event of default,
11 designate a date not earlier than the day such notice is
12 effective as an early termination date in respect of all
13 transactions."

14 So this letter did exactly that and it keyed this to
15 the LBSF filing. The letter came in long after the LBSF
16 filing. So termination had not occurred. As the Court knows,
17 there are numerous events of default that often occur in these
18 transactions, and a non-defaulting party has an option, and
19 often chooses, not to exercise termination. That's what
20 happened in the Metavante case, for example, that the Court is
21 familiar with. So until the notice was sent, the rights that
22 are related to termination were not an issue. And if the
23 termination did not occur, there would be no early redemption,
24 for example, under condition 44 that we're going to talk about
25 that would have to be considered.

1 Now, I'd like to talk a little bit about how these
2 documents deal with the termination notice once it comes in.
3 And significantly, these are things that still have not
4 happened yet. So the full play-out on the documents has not
5 been implemented. First, condition 44 is something that is new
6 in this transaction compared to others we've talked about. And
7 condition 44 has to do with calculation of what is called the
8 early redemption amount. And we have a slide on that which is
9 tab 4.

10 There are two basic ways this happens. The normal
11 way that this occurs in the absence of a default is that there
12 are proceeds from the collateral -- remember this is only after
13 a termination and an early redemption, the collateral is sold.
14 And there is a calculation of what are called unwind costs.
15 And the unwind costs are either a positive or a negative
16 depending upon whether the sway counterparty here, LBSF, was in
17 the money or out of money. Because LBSF was owed a lot of
18 money, they would have been a deduction from the proceeds of
19 the collateral that were, in effect, set aside for LBSF. And
20 then what was left, called the early redemption amount, would
21 flow down the chain -- and maybe we can, if we look back at the
22 timeline -- I meant to keep them both up -- it will then
23 process through clause 5.5. But condition 44 has to be
24 calculated first. And as the Court can see, there has to be a
25 calculation of the unwind costs. There has to be a sale of the

1 collateral. And then math is done under condition 44 and then
2 that goes into clause 5.5 which has to do with the priority,
3 the waterfall.

4 The reason this is important, going back to the
5 calculation, is if there is a bankruptcy and a default then the
6 second part of condition 44 operates. And in that case, the
7 proceeds of the collateral are paid straight through to the
8 noteholder. And then there is no set aside for the swap
9 counterparty. And that clearly operates because of the
10 bankruptcy.

11 The first point on timing is made by the next slide
12 in tab 5. And that is that condition 44 can only become
13 operative after a termination notice is sent. It never
14 operates when there has not been an early redemption or a
15 termination. It requires the sale of the collateral, which has
16 not occurred. And it requires a calculation of the unwind
17 costs by the calculation agent and those unwind costs are not
18 known until the termination has occurred. So, structurally,
19 the rights of LBSF under the first clause of condition 44 were
20 in place and did not change until -- or could have not changed
21 until December 1, 2008.

22 So, once condition 44 is applied and the early
23 redemption amount occurs, there would then be a flow down to
24 clause 5.5. There are two separate ipso facto issues here,
25 Your Honor. The first, in condition 44 and certain related

1 provisions that basically repeat it, is this removal of unwind
2 costs or not. And the second is, once an early redemption
3 amount is calculated, which gate does it go down first? Does
4 it go down to the noteholders, called noteholder priority, or
5 does it go to the swap counterparty, LBSF, called counterparty
6 priority?

7 There are some differences between these particularly
8 when we come to safe harbors. And I want to stress something
9 that's important in this case and others. And that is that
10 condition 44 comes first and it actually has more impact on the
11 money than clause 5.5. And the reason is that if you assume
12 that the collateral is worth roughly the unwind costs plus the
13 noteholders' entitlement, which it's supposed to be if they got
14 the collateral right, then if part is taken away for unwind
15 costs under the first clause, the normal clause, and the second
16 clause of condition 44 is declared to be an ipso facto clause,
17 there's a set aside for unwind costs. A part of that money
18 would flow whichever way it flows in the waterfall. Even if it
19 goes to the noteholders, there should be enough money left
20 over, because that's their entitlement under the calculation,
21 to pay some or all of what LBSF is entitled to. So if
22 condition 44 is invalidated, there is still a significant
23 benefit to the swap counterparty even if clause 5.5 is not. We
24 think they probably go together but we want the Court to
25 understand that they are different because they have some

1 difference in their analytic structure.

2 Now, I'd like to talk about -- I'd be happy to answer
3 any questions if the Court has them at any point including a
4 discussion of condition 44 or clause 5.5, if you'd like to at
5 this point. But otherwise, I'll go on to the English
6 courtroom.

7 THE COURT: Why don't you proceed?

8 MR. MILLER: All right. Thank you, Your Honor. Now,
9 I'd like to explain why the rulings in England have no effect
10 of the ipso facto nature of condition 44 and clause 5.5 under
11 U.S. bankruptcy law.

12 This is a key argument that BNY directs to LBSF's
13 summary judgment. And there are really two branches. The
14 first is a combination of comity and res judicata. And the
15 second is persuasive effect.

16 We think the issues of comity and res judicata are
17 well covered in the briefs, especially pages 33 to 37 of the
18 LBSF opposition. There are a lot of reasons why this is simply
19 not a situation for res judicata or for comity. For example,
20 BNY and LBSF were co-defendants. They weren't opponents in the
21 case. And more importantly, the ipso facto issues under U.S.
22 bankruptcy law were not presented to the English court and
23 everyone agrees that was appropriate. U.S. bankruptcy law is
24 also a compelling part of U.S. policy and comity is not
25 extended cross-border under groups of cases we cite to the

1 Court when there are policy issues in the country that would
2 grant comity that are inconsistent. So because there is no
3 corresponding doctrine to ipso facto and, in fact, many of the
4 property concepts are very different, there's a real policy
5 clash. So we don't think there's really a question of res
6 judicata or comity that can be seriously argued.

7 However, persuasive effect is something that
8 certainly can be argued and we anticipate that BNY is going to
9 say that they think this is an interpretation of English
10 documents and you ought to look to that. The key point there,
11 though, is to understand that the anti-deprivation principle
12 under English law is a common law doctrine that is very narrow
13 and looks at a slice of property rights that are included in
14 Section 541.

15 There's also a second analysis which is a little
16 difficult to explain but I'm going to take a shot at it, which is
17 that the absence of any ipso facto doctrine in England -- it
18 was just completely missing -- caused the English court to
19 assume that certain things that would be invalid based on the
20 LBHI bankruptcy would be valid.

21 So let me take those apart and address them
22 separately. First, tab 6, Your Honor, is a quote from a
23 declaration that was filed by Professor Gerard McCormack,
24 University of Leeds, an expert in English law. And he notes
25 the difference between the ipso facto statutory doctrine in the

1 U.S. and the very narrow common law doctrine which we'll spend
2 some more time with in the committee's discussion as well.

3 He says it's been traditionally recognized in England
4 by Lord Neuberger in Money Markets International Ltd. v. London
5 Stock Exchange Ltd., 2002 1 WLR 1150, that the prohibition of
6 ipso facto clauses in the U.S. Bankruptcy Code is far broader
7 and more comprehensive thereby striking down priority shifting
8 agreements that may be valid under English law. There are
9 actually a lot of parts of the English opinions that can be
10 identified here. We picked out a few, and this is tab 7, our
11 last tab, to emphasize some of the differences between that
12 doctrine and the ipso facto doctrine and especially the
13 property concept under 11 U.S.C. 541. First, we have a quote
14 from the High Court that says that the beneficial interest by
15 way of security that LBSF had in this collateral was, as to its
16 priority, always limited and conditional. And as Professor
17 McCormack explains, limited and conditional interests are not
18 protected by the common law anti-deprivation principle.

19 As the Court well knows, contingent interest,
20 security interest, a broad range of interests become property
21 of the estate under Section 541. The English court put
22 considerable emphasis on the fact that LBSF had agreed to these
23 provisions. But as the Court knows, the U.S. ipso facto
24 doctrine always applies to benefit a debtor who has agreed.
25 And that is, in part, because the protection is for the

1 creditors who didn't agree as opposed to the party who did
2 agree.

3 The English law, as we understand it, does not put
4 nearly as much emphasis on the rights of the creditors and
5 looks a lot at the debtors and what they did. There's another
6 clause here quoted from the Court of Appeals, paragraph 69. He
7 says that the triggering event was the LBHI filing for Chapter
8 11. But as we will discuss in more depth, 11 U.S.C. Section
9 541 prohibits ipso facto clauses even if they purport to
10 operate pre-petition based on the commencement of the case by
11 another party.

12 And finally, this is a really interesting
13 distinction. The Court of Appeals noted that the charges that
14 existed were acquired by money provided by the chargee in whose
15 favor the flip operates. In other words, the Court says well,
16 the noteholder put these funds in and therefore there's a
17 preference to giving the noteholder the funds back. Again, the
18 ipso facto doctrine has never looked at the source of funds.
19 It looks at whether the provision violates Sections 365 and
20 541.

21 So, we believe it is clear, Your Honor, that this was
22 a narrow common law doctrine protecting limited categories of
23 property. It did not recognize conditional interests. And as
24 the Court is well aware, there is a much broader protection
25 under U.S. law. And therefore, the fact that it says these

1 interests were not protected by the anti-depravation principle
2 is really an irrelevant question to what's before the Court.

3 Another key point is that the English court looked at
4 the rights of LBSF without any regard to the existence of an
5 ipso facto doctrine because there was no ipso facto doctrine.
6 It just didn't exist for it. For the reasons that I have
7 discussed with regard to the termination notices, conditions 44
8 and clause 5.5 didn't operate automatically on September 15th.
9 And, in fact, they needed the termination notice. But even if
10 we assume for the purposes of argument that they had been
11 automatic, if, for example, the automatic clause had been
12 selected, then those clauses would have operated on September
13 15 because of the commencement of case under Chapter 11. And
14 as we will discuss in a few moments, they would have been
15 invalid ipso facto clauses. So LBSF would have been protected
16 and those property rights would have still been in existence
17 when LBSF filed. In other words, the ipso facto doctrine would
18 have reached back and protected the clauses. The English court
19 didn't have that on its radar; it was completely invisible to
20 that because it didn't have the ipso facto doctrine. So it
21 said the clauses would have operated under its analysis in its
22 alternative findings even if there had been something to be
23 deprived of. They said it was gone by the time the bankruptcy
24 filing occurred.

25 LBSF can rely on Sections 365 and 541 based on the

1 Chapter 11 filing by LBHI because, as the Court knows, the ipso
2 facto doctrine applies to contract provisions that are
3 activated by the commencement of a case under this title. And
4 that's going to be covered more by the committee's discussion
5 because their briefs have done an excellent job in laying out
6 the compelling legislative history. So the finding that the
7 rights of LBSF were not protected by the anti-depravation
8 principle, which was the only issue before the English court
9 that dealt with timing, is not either persuasive nor binding in
10 the analysis with regard to the reach of Section 541.

11 Now, Your Honor, I'd like to turn briefly to the safe
12 harbor provisions. BNY really places more argument and
13 emphasis on the other issues, the timing issues, and says you
14 never get to 541 or 365. But they do also argue that if you
15 do, you have safe harbors that you have to deal with. The
16 Court has already heard extensive argument of Section 560 as
17 the Court recognizes it's narrowly limited to liquidation,
18 termination or acceleration and offset or net-out. The
19 calculation modifications in condition 44 and the change in
20 payment priority in clause 5.5 do not fit within those terms,
21 as LBSF's motion has shown. LBSF'S briefing also explains why
22 the supplemental trust deed is not a swap agreement within the
23 meaning of Section 560. And I believe counsel for the
24 committee will address further the reasons that the noteholders
25 and the trustee are not swap participants.

1 More importantly, even if these documents were all a
2 single swap agreement, which they are not, the key limitation
3 is still liquidation, termination or acceleration, offset or
4 net-out, and there is absolutely no way that you can
5 characterize, for example, condition 44, which is a calculation
6 formula, as one of those things.

7 Now, BNY has creative reliance on Section 510(a) of
8 the Bankruptcy Code. But that provision which deals with
9 subordination agreements does not apply here. First, Your
10 Honor, we believe it's not a safe harbor at all. And there's
11 no basis to use that provision to declare that facial ipso
12 facto clause would become enforceable. Section 510(a) was a
13 part of the enactment of the Bankruptcy Code in 1978 that
14 includes Sections 365 and 541. It wasn't a subsequent safe
15 harbor that was added. It doesn't have any language that
16 suggests that it's intended to override other provisions of the
17 Code enacted simultaneously. In under standard rules of
18 construction, the entire Code should be harmonized to avoid
19 conflicts. Section 560 and other safe harbors have language
20 that makes it clear that they are to modify Section 365 and
21 they prevent application of the automatic stay, they're much
22 longer. Section 510 just doesn't have any of that language.
23 We believe, if you look back at the history, that the logical
24 function for Section 510 was that enforcement intercreditor
25 subordination agreements, not with the debtor but between two

1 creditors, had become subject to discretionary invalidation in
2 the case law. And Section 510 was a congressional
3 determination that it wanted to remove that discretionary
4 invalidation of subordination agreements between creditors.

5 It's only in the very unusual fact pattern, which we
6 believe is not a subordination agreement, that the debtor would
7 purport to subordinate its rights pre-petition. And if that's
8 done on the basis of a bankruptcy filing, it just is a classic
9 ipso facto clause. And almost any ipso facto clause could be
10 redefined as a subordination. You'd say if the rights of a
11 debtor under a lease are destroyed because of a bankruptcy
12 filing and you say well, it subordinated its rights to the
13 landlord. I mean, at this point, Section 560 would basically
14 invalidate the carefully constructed protections of ipso facto.

15 Further, we believe that subordination agreement is
16 not a defined term but it had a common understanding. And
17 under the understanding, the supplemental trustee is not a
18 subordination agreement. It's not two debtors -- two
19 creditors, I'm sorry, agreeing with the priority that they
20 would have with regard to a debtor that's gone into bankruptcy.
21 And certainly, condition 44, which is a calculation provision
22 that deals with unwind costs in one formula and then another
23 formula without unwind costs cannot be viewed as a
24 subordination agreement.

25 In summary, Your Honor, this Court is presented with

1 an important case of first impression with a complete record.
2 LBSF has demonstrated that it's entitled to a declaratory
3 judgment, the condition 44 and clause 5.5 and certain related
4 provisions that implement them are unenforceable ipso facto
5 clauses. These provisions have not come into operation when
6 LBSF filed its bankruptcy because termination was necessary to
7 activate them. And the modifications they purport to impose on
8 LBSF's rights could not have occurred before the termination
9 notice sent on December 1, 2008. Those purported modifications
10 are prohibited by Sections 365 and 541 of the U.S. Bankruptcy
11 Code. They're not within any safe harbor.

12 For these reasons, LBSF's summary judgment should be
13 granted. I'll be happy to take any questions, Your Honor.

14 THE COURT: I have a fundamental question for you
15 that is really in the form of a hypothetical.

16 MR. MILLER: Yes, Your Honor.

17 THE COURT: Let's just say you're right which I know
18 is a nice way to start a hypothetical. Let's just say you are
19 right and that the flipping of priorities is impermissible by
20 virtue of the ipso facto clause and we end up in a situation
21 where we have a High Court decision validating under the law of
22 England and Wales noteholder priority and we have a
23 determination by this Court that determines that Lehman should
24 have priority because the noteholder priority provisions should
25 be unenforceable. How is that dilemma to be resolved

1 appropriately? And how do we avoid the problem that BNY has
2 been concerned about from the beginning of the case which is
3 being torn apart by inconsistent adjudications by two courts of
4 competent jurisdiction?

5 MR. MILLER: Well, Your Honor, I think the phrase
6 that I used, which, interestingly, I noticed was picked up by
7 the English High Court, is that if that conflict should arise,
8 there would be a conflicts of laws issue that the two courts
9 would have to deal with. And they would have to determine not
10 only the documentary conflicts of laws but the policy conflicts
11 of laws issues.

12 However, Your Honor, it seems to us like, from the
13 standpoint of the estate, the first stage which is the
14 declaration of what U.S. bankruptcy law is is critical to
15 getting to the second stage and figuring out what to do with
16 it. In other words, we don't think that it should be a bar to
17 getting the answer to that question for a couple of reasons.
18 First of all, as the Court well knows, sometimes when an issue
19 like that is resolved, it opens the way to a consensual
20 settlement or other resolution. We never get to the second
21 stage. Furthermore, Your Honor, there is a great body of other
22 disputes out there in which this same issue is important. And
23 so, it will assist the resolution of this estate to get that
24 issue resolved regardless of how this one case that has the
25 unique circumstance of the Perpetual trustee case should come

1 out. So, from the standpoint of LBSF, we believe that it's a
2 critical issue that needs to be resolved. We think it's going
3 to be something that will be beneficial to the entire industry
4 to know the answer to this question. And it should be resolved
5 as a matter of U.S. bankruptcy law. There are many other cases
6 where this conflict cannot arise. If this conflict arises
7 here, I think as the Court has to recognize, and then there's
8 extreme good faith being shown -- and, by the way, I notice
9 there's also judicial good manners being shown that the English
10 court referred to in the transcript -- that the Courts could
11 consult and could determine how they would resolve these
12 issues. And there are other ways, I believe, to resolve them
13 as you go further.

14 We've mentioned the fact that Perpetual may well be
15 amenable to jurisdiction if it came to that at some point. But
16 at this point, we believe that the issue that's before this
17 Court, the English court has agreed can be resolved and will
18 not create a conflict, that is, the declaration. We think
19 there will be another remedies phase if you rule, as we hope
20 you will, in favor of LBSF and how those remedies are fashioned
21 is something that can partake of coordination with the English
22 court. I don't know if that's helpful but that's our view on
23 the timing.

24 THE COURT: It's helpful enough considering that
25 there's no answer to the question.

1 MR. MILLER: Well, any others, Your Honor, like that?

2 THE COURT: No. I don't have any others that I want
3 to trick you with right now. I'll save them for others.

4 MR. MILLER: Thank you, Your Honor.

5 THE COURT: Okay.

6 MR. MILLER: At this point, the committee, Your
7 Honor, is going to --

8 THE COURT: The committee is going to speak to
9 certain issues now?

10 MR. MILLER: -- speak to certain issues.

11 MR. FOSTER: Good afternoon, Your Honor. Wilbur
12 Foster of Milbank Tweed Hadley & McCloy on behalf of the
13 official committee of unsecured creditors. I'm going to
14 address several particular points and I'm not going to cover in
15 detail points that we already covered in detail in our
16 submissions. But there are several points that I do want to
17 hit and emphasize here today.

18 The first one is on the application of Section
19 365(e)(1) and 541(c)(1) in this transaction. BNY has
20 consistently taken the position that a bankruptcy filing by
21 LBHI is not picked up by Section 365(e)(1)(B) or 541(c)(1)(B)
22 in a bankruptcy case of LBSF. They stated in their September
23 25th memorandum: "Conditions specified in Section 365(e)(1)
24 relate exclusively to the debtor and not to any third party."
25 A similar statement in their October 23 memorandum: "Section

1 365 functions as a bar to the enforcement of ipso facto clauses
2 only where a debtor's contractual rights are terminated or
3 modified as a result of the debtors', not a third party's,
4 insolvency or bankruptcy filing." That's on page 6 of their
5 October 23 memo. In their November 9th reply memo, they make a
6 similar point, pages 11 to 17, and also include Section
7 541(c)(1) as part of that argument.

8 There are three problems with BNY's argument on this
9 point. First, it's not supported by the plain language of
10 Section 365(e)(1)(B) or 541(c)(1)(B). Those provisions are not
11 written in a specific or limiting manner. They are written in
12 a general matter, "the commencement of a case" under this
13 title.

14 Second, the legislative history of those provisions
15 shows -- or supports the conclusion that those words mean what
16 they say. They're not limited; they're broad. We spent four
17 pages in our September -- or, excuse me, October memorandum
18 analyzing this. But just to summarize that legislative history
19 here, the original proposed bankruptcy reformat in 1973 had
20 predecessors of Sections 541 and 365 in it. The predecessor of
21 541 that was proposed in 1973 and was in four House bills and
22 four Senate bills in 1973, 1974 and 1975 all had language "the
23 filing of a petition" with respect to 541 and language "the
24 commencement of a case under this Act by or against the debtor"
25 with respect to Section 365(e)(1) -- what is now 365(e)(1). So

1 there is general non-limiting language for Section 541 and very
2 limiting language -- in fact, language that said exactly what
3 BNY is arguing, that the ipso facto prohibition in 365 should
4 apply only to "the commencement of a case under this Act by or
5 against the debtor". That's what the bill said, eight of them,
6 in '73, '74, '75, as well as the original 1973 commission
7 proposed statute.

8 In 1977, these bills were amended. The 365(e) was
9 changed to have the commencement of "the case" under this
10 title, again, more limiting the commencement of "a case",
11 particularly given the reference to "the case" earlier in 365.
12 Section 541(c) was amended to refer to "the commencement of a
13 case under this title concerning the debtor". If that would
14 help BNY once 541(c) read and if that provision had been
15 enacted, it'd be a good argument. Later, however, these bills
16 were amended -- 541(c) was broadened again and, ultimately,
17 both Section 365(e) and 365(b)(2) were broadened to
18 consistently say, across the board, that they apply to "the
19 commencement of a case under this title".

20 Now, we go through this analysis of all these bills
21 and what started, what evolved and what came out of it. In
22 their November 9th memorandum of law, BNY declares in response
23 to this, "No evidence supports this thesis." That is, the
24 thesis that a bankruptcy case of somebody other than the debtor
25 could be implicated by these provisions. They go on to say

1 "The detailed legislative history laid out at pages 18 to 22 of
2 the committee's memorandum contains no evidence that Congress
3 gave any consideration to the consequences of using either the
4 indefinite article or the definite article in these Code
5 sections." That's BNY's position.

6 Our response to that is that this legislative history
7 is, in fact, itself evidence, evidence of Congress' intent. I
8 cite on that point a Second Circuit decision, Benjamin v.
9 Fraser, 343 F3d 35 (2nd Cir. 2003), in which the Second Circuit
10 was considering a prison-related law. And the question was
11 whether it was impermissible for courts to have monitors going
12 into prisons. And the Second Circuit discussed the law that
13 was enacted but did not have a restriction on the use of
14 monitors and cited a prior bill that did have such a
15 restriction. And the Second Circuit said we can't look -- we
16 look at the prior bill that had this restriction. We can't say
17 that the current -- the statute was passed -- the ultimate bill
18 does not have that restriction. They had that restriction
19 dropped. We cannot lead that restriction into this bill when
20 it was considered by Congress, dropped and not put into final
21 law. In that law, the Second Circuit said, and I quote, "Well
22 settled principles of statutory construction dictate that where
23 Congress includes limiting language in an earlier version of
24 the bill but deletes it prior to enactment, it may be presumed
25 that the limitation was not intended." Citing a Supreme Court

1 case, Russello v. United States, 464 U.S. 16 at 23 (1983).

2 The Second Circuit goes on to say, "The Supreme Court
3 has instructed that few principles of statutory construction
4 are more compelling than the proposition that Congress does not
5 intend sub silentio to enact statutory language that it has
6 earlier discarded in favor of other language." Citing another
7 Supreme Court decision, INS v. Cardoza-Fonseca, 480 U.S. 421,
8 442-43 (1987).

9 So contrary to what BNY seems to think or what its
10 view of this legislative history is, the fact is that it is
11 itself evidence of what Congress was intending, what it was
12 doing. It is evidence that Congress did not intend to put in
13 Section 365(e)(1)(B) or Section 541(c)(1)(B) the limitations
14 that BNY wants to impose on them.

15 Third, reading these provisions in this manner
16 without limiting it to the debtors' case is consistent with the
17 general principle that cross-default clauses in bankruptcy --
18 and that's what this is. It's an LBHI filing, constitutes a
19 default under an LBSF contract. Cross-default provisions are
20 inherently suspect -- and on this point, I cite Your Honor's
21 November 17th, 2009 decision --

22 THE COURT: I was wondering if anybody's going to
23 bring that up.

24 MR. FOSTER: Got it right here, Judge. In re Charter
25 Communications, you have the citation of, as you pointed out,

1 "Cross-default provisions are inherently suspect and a
2 determination to enforce a cross-default is necessarily fact
3 specific." So BNY would have you say you could never have
4 somebody else's bankruptcy be relevant under Section
5 365(e)(1)(B). That is wrong as a matter of law. And as a
6 matter of fact, what you do is you look at it's fact specific.
7 You can't totally exclude it. And when you have related
8 entities such as here, you have a close related subsidiary,
9 parent guaranteed its obligations. You can't look at these
10 cases as being unrelated. To use language from your decision,
11 Your Honor, and to paraphrase it, an event of default based on
12 the financial condition or the bankruptcy of LBHI is
13 necessarily connected both factually and contractually to the
14 financial condition in the bankruptcy of LBSF.

15 So whether it's a 365(e)(1)(A) or (e)(1)(B), it's a
16 similar principle. And although your decision dealt with
17 Section 365(b)(2) as incorporated by Section 1124, the language
18 in (b)(2) is the same as the language we're talking about in
19 365(e) and 541(c). So because of the plain language of the
20 statute, the legislative history and the general treatment of
21 cross-default provisions, it's inappropriate to ignore and to
22 say, as a matter of law, that LBHI's bankruptcy filing cannot
23 come within 541(c)(1)(B) or 365(e)(1)(B).

24 There is one reference in BNY's brief where they're
25 positing this parade of horrors and what is the extent of

1 this. Again, it's going to be a question of fact. It depends
2 on the particular circumstances. You can't exclude the
3 analysis completely. One of the concerns they pointed to well,
4 what about state court insolvency proceedings? Won't that be
5 an issue? Well, I don't think so because 541(c)(1)(B) and
6 365(e)(1)(B) refer to "a case under this title". So I'm not
7 going to worry about what happens in state courts.

8 So for all those reasons, Your Honor, LBHI's filing
9 is one that can and in these cases -- can be and, in this case,
10 is covered by Section 365(e)(1)(B) and Section 541(c)(1)(B).

11 The second point I wanted to cover, Your Honor, has
12 to do with the application of the safe harbors to noteholder
13 priority and condition 44. We spent a lot of time on this in
14 our briefs. I'm not going to repeat that time now. I have to
15 say that it is difficult because BNY goes all over the place on
16 this issue. Their point seems to be, however, that -- and I'm
17 going to quote them here: "Nothing in the wording of Section
18 560 or any other provision of the Code suggests that the safe
19 harbors for swap agreements, in this instance, should be read
20 narrowly and applied only in limited circumstances." That's in
21 their October brief at 12.

22 Well, as a matter of fact, those provisions ought to
23 be applied only in limited circumstances. The swap agreement
24 safe harbors can be invoked, number one, only for specified
25 activities; number two, by a swap participant; three, under or

1 in connection with a swap agreement.

2 In BNY's many submissions, they never identified who
3 the swap participant is that is exercising noteholder priority
4 and condition 44. And they don't do it, and they also don't
5 identify the swap agreement that makes that party a swap
6 participant. They don't do it because they can't do it. We'll
7 stipulate for the purpose of this proceeding that the SPV
8 Saphir had a credit default swap with LBSF, that the credit
9 default swap is a swap agreement as defined in the Bankruptcy
10 Code and that the SPV Saphir is a swap participant. So we have
11 swap agreement and there's a swap participant. That doesn't
12 mean that everybody involved in the transaction somehow some
13 way gets the benefit of the safe harbors. The noteholders
14 simply are lenders to the SPV. And they have liens securing
15 their loans to the SPV. They have liens on the collateral of
16 the swap participant which is the same clout the swap
17 participant pledged to LBSF to secure the swap participant's
18 obligations to LBSF. There is -- by no way of imagining could
19 these noteholders be viewed as swap participants. They try to
20 argue that there's a security agreement and therefore the
21 security agreement is a swap agreement. And we point out in
22 our memo that a security agreement can be a swap agreement but
23 only to the extent of damages as computed under Section 562.
24 There are no damages under 562 here. Saphir has no damage
25 claim. Saphir owes money to LBSF.

1 In addition, the swap agreement is securing notes.
2 Excuse me. The security agreement, with respect to the
3 noteholders, is securing claims under notes. Notes are not
4 swap agreements. So whether it's the noteholders exercising
5 their rights under noteholder priority or clause (sic) 44 or
6 it's the trustee acting on their behalf, neither is a swap
7 participant because neither has a swap agreement. They are
8 putting through it all pure and simple secured creditors,
9 secured lenders to the SPV. And the fact that the SPV is,
10 we'll stipulate, a swap participant doesn't change the status
11 of the lenders. That's all they are. They are lenders with
12 collateral securing their claims.

13 BNY seems to take the view that there are somehow --
14 and again, this is -- there's a -- their arguments move around
15 this. They never quite -- there's a lot of references to swap
16 agreements, almost no reference to swap participants. A lot of
17 generalities. But their position seems to be that this is a
18 single integrated transaction and therefore there's one
19 agreement and that since there's a swap agreement somewhere in
20 the middle of this then every other agreement now is drawn into
21 that, drawn into the vortex of a swap agreement. And since the
22 noteholders and the trustee are parties to some of these other
23 agreements, even though they aren't parties to the credit
24 default swap, they are somehow parties to a swap agreement.
25 They say here -- they say that because the transaction

1 documents create an integrated transaction, none of which would
2 have been executed without the others, they should be read
3 together as a single contract. That's in their September
4 brief. And they make the same point later that "these multiple
5 documents constitute a single indivisible contract".

6 That's far-fetched. And the case they cite for that,
7 the Cooperativa Centrala decision, doesn't support that
8 proposition at all. It simply says that when you have
9 documents executed at the same time as part of the same
10 transaction, you read them together to interpret them. But it
11 doesn't say that you've got one contract. It doesn't say that
12 the credit default swap and the security agreement and the
13 notes and everything else in this deal constitutes one single
14 contract and that that contract is a swap agreement. There's
15 no support for that and it defies common sense.

16 They try to make the point that -- saying that this
17 is a swap agreement is -- and this is from their November
18 memo -- "Consistent with the English judgments, the market
19 views Section 5.5 and condition 44 as part of a swap agreement
20 for purposes of Section 560 and 362(b)(17)." That's on page 38
21 of their November memorandum of law.

22 Well, first, they presented no evidence about the
23 market view. But second of all, the citation of the English
24 court decisions is interesting and actually counterproductive
25 from their perspective because if you turn to paragraph 132 of

1 that decision, Lord Justice Patton, who BNY cites several times
2 in their November memorandum so they apparently give his views
3 some weight -- he says at the end of paragraph 132, "The
4 noteholders were not parties to the swap agreement and their
5 only contractual rights to payment or to payment under the
6 notes." So this is from an eminent justice, English justice,
7 and it supports everything that you can see from looking at
8 this transaction. They're not parties to the swap agreement.
9 The English court decision undercuts their argument or at least
10 their implication that they somehow are. They never come out
11 and say that the noteholders or the trustee acting on their
12 behalf is a swap participant. They cite the term swap because
13 of -- twice in each of their October and November memos but
14 they never say who the swap participant is. And the reason is
15 they can't because if they said who it was, it wouldn't help
16 their argument. If there's a swap participant, it's Saphir and
17 Saphir is not the party exercising the rights in question here.

18 The briefs go into great detail about how the
19 enforcement of noteholder priority and condition 44 don't
20 constitute liquidation within the meaning of Section 560. We
21 traced that language back to legislative history. That
22 language deals with the ending of a contractual relationship.
23 It doesn't deal with actual liquidation of collateral.
24 362(b)(17) deals with liquidation of collateral.
25 Unfortunately, for BNY, the liquidation of collateral has to be

1 done by a swap participant. And as I just said, it's not being
2 done by a swap participant. But even if somehow some way, and
3 we're not conceding this for a moment, but there is a swap
4 participant somewhere in this deal, Saphir. Even if somehow
5 some way one could say that what was being done there was being
6 done by Saphir, that is still not the kind of right that
7 Section 362(b)(17) protects. We've tracked the history of that
8 provision from its predecessor, 362(b)(6), 362(b)(7) and even
9 quotations in BNY's own briefs indicate that the purpose of
10 those provisions is to ensure that the swap agreement gets
11 paid, gets paid for the cost of cover, gets paid for its
12 termination claim, if it has one, against the counterparty.
13 Those provisions are not in there to enable a swap participant
14 to be able to deal with property in which a debtor has an
15 interest. Deal with it free in the Bankruptcy Code in order to
16 pay off a secured lender of the swap participant. It's just
17 not there for that purpose. So Saphir is not enforcing these
18 rights. But even if somehow, some way, somewhat it could
19 conjure up an argument as to who they are, the fact is that
20 those provisions, 362(b)(17), like their predecessors, aren't
21 designed to protect the ability of a swap participant to hand
22 out property to a simple straight secured lender to the swap
23 participant in derogation of the rights of a bankruptcy debtor
24 counterparty.

25 The third point I wanted to just touch on -- oh, one

1 last point on that. There's a lot of comments in BNY's papers
2 about market disruption and how the markets are going to be
3 upset if the Court grants the relief that LBSF is seeking.
4 First of all, there's nothing in what they cite that talks
5 about disruption in the swap markets. If you look at what
6 they've cited as evidence of the concern that's raised in the
7 market and look at their own language themselves when they talk
8 about the financial markets. He's very broad -- the mention
9 the securitization market. These provisions were put in the
10 Code to protect the swap markets. Now if other lenders have
11 some problems because of the Bankruptcy Code, well, the fact is
12 Congress didn't seek to protect them. I found one of the
13 articles they cited particularly telling and it says a lot
14 about what's going on here. While all the articles talk about
15 how this is a concern not in the swap markets but in the
16 structured finance for collateralized debt obligation markets
17 where parties lent money expecting particular treatment and if
18 they don't get it, then that could change the ratings. Well,
19 the problem is if you lend money in a structure that has
20 features that run afoul of the U.S. Bankruptcy Code, there's a
21 good chance that your expectations will be dashed. And the
22 problem isn't a ruling that upholds the Code. The problem is
23 people who put money in the structures that didn't take into
24 account the possible effect of U.S. bankruptcy law.

25 One article that's cited by BNY, "U.S. Court to Hear

1 a Lehman Brother Swap Case", makes -- has a concluding sentence
2 that I think is an appropriate comment on this -- in general.
3 The article says "The case" -- this one -- "also highlights the
4 difficulties in unwinding the structured vehicles that were set
5 up during the credit boom and without failure in mind." That's
6 one of the articles they cited.

7 That's what happened here. Lenders lent money to a
8 vehicle. They didn't think through the potential issues. If
9 LBSF became a debtor in a case under the Bankruptcy Code and if
10 that was their mistake then they can go blame whoever advised
11 them, they can blame the rating agencies. Lo and behold, the
12 rating agencies got one wrong, never happens. But that's not a
13 problem for the bankruptcy court; that's not a problem for the
14 Bankruptcy Code.

15 The last point I wanted to touch on -- and this is,
16 again, without -- it just mentioned this. It's mentioned in
17 footnotes in our November memorandum and in LBSF's memorandum.
18 Without conceding a point at all or undermining Mr. Miller's
19 very able and -- argument on this, if this Court were to rule
20 that the change in rights here happened pre-bankruptcy,
21 September 15th, as BNY argues, and the back change did not run
22 afoul of the ipso facto provisions then Lehman should be given
23 leave to amend their complaint to include avoidance actions to
24 pick up what was, if that were the case in that ruling, would
25 have been pre-petition changes, deprivations of rights of LBSF.

1 This is -- and the support for this is even BNY in its own
2 briefs talks about a loss, a change of LBSF's rights based on
3 the September 15th filing. They talk about a claim of priority
4 that was "lost" pre-petition. They refer to "rights lost pre-
5 petition". The loss of rights can be challenged as a transfer.
6 And this transfer, if it occurred, as BNY argues, on September
7 15th, 2008, is potentially subject to challenge particularly
8 given the inapplicability of Section 546(g) because of the lack
9 of a swap participant with respect to those transfers.

10 That would also be consistent with the English court
11 decision itself. A number of times, as Mr. Miller mentioned,
12 the English court -- the High Court -- Court of Appeal, excuse
13 me, emphasized that they were just construing a common law
14 rule. And on a number of occasions, for example, paragraphs 57
15 and 91 of the decision, they pointed out that there was a
16 comprehensive statutory scheme in England, the Insolvency Act
17 of 1986, that could be used to examine and challenge three
18 insolvency transactions that deprived a debtor of its property
19 rights. And indeed, in at least three places in the opinion,
20 paragraphs 52, 71 and 92, the decision refers to Sections 238
21 and 239 of the Insolvency Act of 1986 as possible ways to
22 challenge pre-bankruptcy transactions that the private debtor
23 or property rights. Well, 238 is the Insolvency Act's
24 equivalent of Section 548 dealing with fraudulent transfers.
25 And 239 is the equivalent of Section 547 dealing with

1 preferences.

2 So, for that reason, just to point out, if for some
3 reason the Court were to rule that the change in rights did
4 take place on September 15th and it did not run afoul of the
5 ipso facto provisions, we respectfully request that LBSF be
6 given leave to amend their complaint to challenge those
7 pre-petition transfers and deprivations of property rights.

8 Is there any questions?

9 THE COURT: I have some, but I think I'm going to
10 keep them to myself for now. One of my questions, actually, is
11 procedural. And this is really a question for all the lawyers.
12 These are cross motions for summary judgment. There is
13 apparently a factual dispute as to the operative date. Is that
14 something which is factual or is that a legal matter as to
15 which I can make the decision without evidence as to whether
16 we're talking about an operative date of 9/15, 10/3 or 12/1?
17 And the reason that I'm focused on the 12/1 date is that the
18 materials that were presented during argument by Mr. Miller
19 focused on a December 1, 2008 letter from Saphir Finance which
20 is a swap counterparty to Lehman Brothers Special Financing,
21 declaring a termination event.

22 Is this something as to which the facts are in
23 dispute, or is this something as to which the facts are
24 undisputed?

25 MR. MILLER: Your Honor, Ralph Miller again. LBSF

1 believes that all the facts are in the record that are going to
2 exist, and it's a question of applying the law to those facts
3 to determine what their consequence is. So we believe this is
4 a legal issue. It's not a disputed issue of material fact. We
5 don't think there's any missing notices out there or other
6 documents or anything else factual that can be brought to bear.
7 It's a question of reading these documents and figuring out
8 what they mean. But I don't know what the position of BNY is,
9 Your Honor. That's LBSF's position.

10 THE COURT: Okay.

11 MR. FOSTER: Should I step down, Your Honor?

12 THE COURT: Yes, thank you very much, Mr. Foster.

13 MR. SCHAFFER: Good afternoon, Your Honor. Eric
14 Schaffer, Reed Smith, on behalf of BNY Corporate Trustee
15 Services Limited. Let me start where we just finished. I
16 think the dates are a matter of record here in terms of what
17 debtors filed when. I don't believe there's any issue with
18 regard to when the termination notice was sent.

19 THE COURT: Okay.

20 MR. SCHAFFER: Your Honor, I'd like to start by
21 talking about three straw men and an elephant in the room.
22 Looking at the briefs filed by LBSF, there are a number of
23 straw men I think they're setting up. And the first is that
24 BNY denies the estate has any interest in collateral. We don't
25 deny they have an interest. They clearly have an interest.

1 But the interest is determined on the petition date. And on
2 that date it is subordinated to the interest of the noteholder.

3 Second straw man is that we think the English courts
4 should be determining US bankruptcy law. While theoretically
5 they might, I don't think that's happening here. I think our
6 position, agreeing with what the Court has said earlier, the
7 English courts should be deciding English law. This Court
8 should be deciding bankruptcy law.

9 The last is the suggestion that we're looking to
10 delay, as evidenced by a reference to coordination. That
11 reference is limited to what would happen next if this Court
12 were to enter a declaratory judgment as requested by Lehman.
13 It has no relevance. We're not looking to delay anything.

14 What's the elephant in the room? It's the Supreme
15 Court's decision in Butner. The debtor and the committee filed
16 briefs totaling 196 pages, and not once did they mention the
17 Butner decision. This case is not about swap terminations; it
18 is about rights in collateral. And the threshold issue, the
19 heart of this case, is what rights did Lehman have, what did it
20 actually have when it filed its petition. They assume they had
21 priority on the petition date, but they never really address
22 it.

23 Of course, under 541(a), the estate is fixed on the
24 petition date. If the rights on the petition date were
25 subordinate to the rights of the noteholder, they cannot use

1 bankruptcy to enhance their interest. The stay doesn't help
2 them because the stay affects post-petition acts. It's the
3 same with regard to the prohibition on enforcement of ipso
4 facto provisions. It has no relevance if we're dealing with
5 pre-petition decisions or pre-petition actions.

6 So under *Butner v. U.S.*, under the Supreme Court's
7 subsequent decision in *Piccadilly Cafeterias*, you start with a
8 determination made under applicable nonbankruptcy law, here
9 English law, to determine what rights the parties have. And,
10 Your Honor, *Butner* says that the bankruptcy court should take
11 whatever steps are necessary to ensure a creditor receives the
12 same protection he would have under state law, if no bankruptcy
13 had ensued. Bankruptcy doesn't alter, it doesn't affect pre-
14 petition priorities. And an interest that was extinguished
15 pre-petition or that didn't exist, cannot be revived.

16 So what are the rights on the petition date? The
17 Court of Appeal confirmed that the priority change here
18 occurred automatically and immediately when LBHI filed eighteen
19 days before this debtor filed. And I would note that LBHI has
20 no interest in the collateral we're talking about here. The
21 decision of the Court of Appeals was by the Master of the
22 Rolls. He gave the leading judgment. He happens to be the
23 same Lord Neuberger who was cited by Lehman's expert. But the
24 Master of the Rolls explicitly found that the filing by
25 Holdings, not the subsequent swap terminations, triggered what

1 we've referred to as the waterfall flip, the subordination of
2 collateral rights.

3 The Court of Appeals also has denied leave to appeal.
4 So the code sections that protect rights after commencement of
5 the bankruptcy case, we think are irrelevant. You can't create
6 an interest that never was property of the estate when a case
7 started. The Code can't be used to reverse a pre-petition
8 priority change. 365(e), as I noted, relates to enforcement of
9 ipso facto clauses, only where a contract is being terminated
10 or modified or there's an attempt to do that post-petition.
11 Here, again, it happened pre-petition.

12 Also of interest is that under English law, there's
13 no modification. The Court of Appeal found that Lehman never
14 had more than a limited contract right, and its right wasn't
15 modified by the priority flip. The Court explained that
16 collateral was acquired with the holders' money, and so long as
17 there was no default, Lehman had priority in unwinding the
18 transaction, but holders had priority if there were a default.
19 So as a matter of English law, the Court found that Lehman had
20 the same asset before and after the default. They expressly
21 state it was not divested of any interest.

22 Now, while the Court of Appeal did, of course,
23 consider English insolvency law, That's not all it considered.
24 And what's relevant here is the determination in the first
25 instance of the parties' contract rights under English law.

1 And it found that English insolvency law was not engaged
2 because the triggering event was Holdings' filing. It states
3 that in paragraph 69.

4 Now, it's important that the waterfall flip, as we
5 call it, occurred pre-petition based on the Holdings filing,
6 because 365(e) and 541(c) are modification based on the
7 bankruptcy of the debtor, not a third party. Yes, we disagree
8 on this. And I think you can start with the policy of
9 protecting against a post-petition loss of contract rights.
10 It's not implicated where the priority change occurs
11 pre-petition. And similarly, the stay is not violated based on
12 a pre-petition action.

13 Now, LBSF wants to treat this case as if it were
14 filed, for your purposes, on September 15. And its argument is
15 based on reading the reference in 365(e)(1) to "a case" as a
16 reference to a bankruptcy case filed by some other debtor than
17 the one that's now before this Court. That fails for a number
18 of reasons, and to start with the most obvious, it didn't file
19 then. It could have filed the same date as Holdings, it did
20 not.

21 But let's look at what authority supports or doesn't
22 support this. There really is nothing in the statute. There's
23 nothing in the legislative history that really supports this.
24 We do cite one decision, the Amcor decision. They do not cite
25 any other case law. It seems there's not a lot of case law on

1 this. But the history that the committee points to doesn't
2 really speak to this issue.

3 So we employ the tools used for statutory
4 construction, and we note that the code uses the terms "a case"
5 and "the case" almost interchangeably, sometimes in the same
6 sections. But looking at this, the most natural reading of
7 365(e)(1), natural reading of "a case" is to refer to
8 provisions in a pre-petition contract in which some theoretical
9 bankruptcy filing could result in a default. These sections
10 apply to a contract that provides for termination or
11 modification if there's some future bankruptcy, but it doesn't
12 refer in any way to a third party. And we note that this is
13 consistent with rules of grammar as well.

14 Additionally, the notion that you can somehow reach
15 out, grab onto a prior filing, is inconsistent with settled law
16 regarding the separateness of corporate entities. This theory
17 of theirs would eliminate the corporate veil for selected
18 purposes, without any evidentiary proceeding. And yes, it also
19 could lead to a lot of uncertainty. What cases are covered?
20 How far back does it go? Does it go back eighteen days? Does
21 it go back eighteen months? This is a very uncertain route
22 that they would have the Court take. And I think they
23 understand that they need to somehow narrow this, because
24 that's why Lehman proposes to limit its reading of "a case" to
25 a "closely related affiliate."

1 Now, I'd note here that Holdings is not a party to
2 the supplemental trust deed. But this notion that there should
3 be a tie to a closely related affiliate is not borne out in the
4 code or in the legislative history. When Congress wanted to
5 refer to close relationships, it had no trouble doing it very
6 clearly. 547, 548 talk of insiders, a defined term in Section
7 101.3 There are special provisions for co-debtors in 509; for
8 joint cases in 302; affiliates is a defined term. If special
9 rights were intended here, Congress certainly would have found
10 the words.

11 There's also a reference made by LBSF to equity.
12 They say they're not seeking an equitable exception, but then
13 they invite the Court to "consider equitable factors." Well,
14 the cases they cite do not give them a license to expand their
15 rights, and there's nothing in equity that empowers the courts
16 to alter code provisions. The rights, again, are fixed at the
17 date of the petition.

18 Let's turn, then to the notions of comity and res
19 judicata. What respect should be accorded to the decision of
20 the Court of Appeals. I think what they're saying here is they
21 want to relitigate what was tried there and affirmed on appeal.
22 The judgment of the Court of Appeal is entitled to recognition
23 under the doctrine of comity, and to full and preclusive effect
24 under the doctrine of res judicata.

25 Let's start with comity. They say comity can't

1 affect application of the Bankruptcy Code. We agree. But the
2 Bankruptcy Code only applies to the estate as it existed on
3 October 3. LBSF also says don't reward Perpetual. But this
4 case isn't about whether someone is rewarded or not. It's not
5 relevant to the issue presented, which is a determination of
6 rights under applicable nonbankruptcy law on the petition date.

7 In their brief, I think LBSF confused comity as it
8 relates to jurisdiction, something that we dealt with in the
9 motion to dismiss, and comity as it relates to the English
10 judgment dealing with English contract law. They're very
11 different. The summary judgment motions that you have here
12 today require comity as it relates to the judgment, not with
13 regard to bankruptcy law but as it relates to English contract
14 law. Under Butner, that's what we look to to determine the
15 rights the debtor has of commencement. You're not bound by
16 English insolvency law. But we're not suggesting you should
17 be. English contract law is what binds the Court, is what
18 determines property rights under the Butner decision.

19 Now, if a foreign judgment is dealing with core
20 bankruptcy issues, comity might be denied. But that's not what
21 we're talking about here. We're talking about determination of
22 rights under English law, and comity is particularly
23 appropriate when we're talking about property rights under the
24 law of the foreign court that is deciding it. What are the
25 relevant factors dealing with comity? Was there a full and

1 fair trial? Yes. Is the English court competent? Is it
2 familiar with these documents and with its own law? I think
3 that's conceded. Did LBSF appear voluntarily? Well, they
4 moved to intervene. They consented to jurisdiction. There is
5 no evidence of fraud, of unfairness or prejudice. So I think
6 comity certainly applies here.

7 Let's then turn to res judicata. Once again, this
8 Court does not write on a clean slate. It's looks to
9 applicable nonbankruptcy law. The English court, in deciding
10 contract law, decided issues that are entitled to respect. Are
11 the issues the same here? Well, the issues here and in the
12 English courts both involved -- both actions involved
13 applicability and enforceability of priority provisions in the
14 transaction documents. And, Your Honor, I would in particular
15 note that in a filing in the High Court last week, LBSF stated,
16 "The central issue in the proceedings before the English court
17 and the US bankruptcy court is the entitlement to collateral
18 held by the first defendant, BNY." So the issues seem to be
19 the same.

20 Are the parties the same? LBSF says well, the
21 trustee, LBSF are both parties in England, but there's no res
22 judicata because they are codefendants. I think it's a little
23 ironic that they're saying that we're here in some different
24 capacity because they opposed our motion to dismiss on the
25 basis that we are here as an adequate representative of

1 Perpetual. And indeed, they call us in their last brief, a
2 proxy for Perpetual. I think we're here because we have been
3 deemed to stand in Perpetual's shoes. And res judicata, as we
4 note in our brief, applies when the interests involved in a
5 prior litigation are virtually identical to the later
6 litigation.

7 This so-called virtual representation extends to
8 those that are deemed to have the same interests. Indeed, if
9 they're saying we aren't deemed to have the same interests,
10 then I guess we're entitled to dismissal because they must
11 think we're not really here as an adequate representative for
12 Perpetual.

13 Just to finish with the standards for res judicata.
14 Is there a judgment by a court of competent jurisdiction? I
15 think they concede that. Was there a final disposition after
16 trial? Yes. It was done in accordance with the rules of
17 procedure. It was affirmed on appeal. We're not invoking
18 comity to delay. To the contrary, looking to the decision of
19 the Court of Appeal can expedite determination of the rights on
20 the petition date under English law.

21 Two final notes on comity and res judicata. Your
22 Honor, if we weren't entitled to have the decision of the
23 English court respected under res judicata, the similar
24 doctrine of collateral estoppel would be invoked. And even if
25 that were not invoked, even if that were not binding on Lehman,

1 the decision of the High Court confirmed by the Court of Appeal
2 is extremely persuasive with regard to the application of
3 English law on the very same documents that were before that
4 court and are before this Court.

5 Let me leave that argument behind and turn to
6 enforcement of subordination agreements. Even if LBSF were not
7 subordinated pre-petition, we've argued it should be
8 subordinated under Section 510(a). Now, subordination
9 agreement is not defined in the code. But there are no
10 formulaic limitations. Collier notes that Section 510(a) is of
11 unqualified breadth. In the Best Products case, Judge Brozman
12 said, "It is simply a contractual arrangement whereby one
13 creditor agrees to subordinate its claim against a debtor in
14 favor of the claim of another."

15 Now, LBSF is here as one of two competing claimants
16 with rights that are established in the transaction documents
17 determining their relative priority. The fact that it may be a
18 debtor in this case does not mean that it's not a competing
19 claimant for purposes of 510. It doesn't take it outside the
20 statute. Nothing in the statute says "unless you're a debtor."

21 Looking then, what did the Court of Appeal find? It
22 looked at section 5.5; it looked at condition 44. And it said
23 they provide for subordination of the claim of one claimant to
24 the claim of the other. That's a subordination agreement. And
25 under 510(a) it's enforceable to the same extent as under

1 nonbankruptcy law. The Court of Appeal found it is enforceable
2 under applicable English law. And because it is enforceable as
3 a subordination agreement, it must be enforced here in
4 accordance with its terms.

5 Now, two other points I want to make with
6 subordination agreement. One is, again, as noted previously,
7 the Court of Appeal found that as a matter of English law,
8 there's no modification. Lehman's rights under English law are
9 unchanged. Nothing was divested. But let's move on from that
10 to what I think has been identified by Lehman as the tension
11 between 510(a) and Sections 365(e)(1), 541(c)(1). They
12 identify it. They say that 510(a) has to yield. They never
13 really explain why.

14 Well, Your Honor, Section 365(e)(1) is not the prime
15 directive. It's not a section that all others must yield to.
16 Why does 510(a) take priority? Well, it takes priority under
17 the rule that a specific statute controls over a general
18 provision. 365 deals with the wide and varied universe of all
19 executory contracts. 510(a) addresses a very narrow subset,
20 that being subordination agreements. And 541(c) doesn't negate
21 any valid pre-petition limitations. So if we did not prevail
22 based on the property of the estate, I think we win based on
23 the subordination agreement.

24 Let's turn then to the final argument which is
25 whether priority provisions are enforceable under the safe

1 harbors. The Court never gets to the safe harbor argument if
2 it finds that noteholder priority was effective pre-petition in
3 accordance with the English court's decision and in accordance
4 with Butner. If you don't agree with regard to the property of
5 the estate, the safe harbors still lead you to the exact same
6 result. Because in closing out the swaps, the priority is
7 effective automatically at the time of the LBHI filing, our
8 first argument; or if it's not, it's enforceable automatically
9 as part of a swap agreement within the safe harbor.

10 The waterfall flip we've argued, is within the broad
11 safe harbor protecting the rights of nondebtor parties to swap
12 agreements. Let's start with defining what the agreement is,
13 then let's look at the code. In Section 101.53(b) Congress
14 gave swap agreement the broadest possible definition. It's a
15 functional definition. It encompasses whatever the market
16 deems to be part of the transaction.

17 The definitions says it includes all terms that are
18 incorporated by reference. And here, these transaction
19 documents have more than forty internal cross references. The
20 interdependence shows we're dealing with a single integrated
21 agreement. The supplemental trust deed, which includes section
22 5.5 and condition 44, is clearly part of the swap agreement,
23 because the ISDA schedule, paragraph 5(g), which was not
24 included in the materials handed up to you earlier today, 5(g)
25 expressly includes the trust deed and provides that it controls

1 if there's any conflict.

2 If it's not part of the swap agreement, then the
3 provisions are effective only upon swap termination. This has
4 to be viewed as an integral part of the swap agreement.
5 There's no real argument here that anyone would enter into one
6 document without the others. There's no argument that can be
7 made that a party would enter into the supplemental trust deed
8 by itself. It only makes sense as part of what the Court of
9 Appeal characterized as a single scheme. And indeed, LBSF, in
10 the Libra and the Ballyrock cases, said that these cross
11 references in similar documents, show the documents "operate
12 together inextricably."

13 Of course Congress created broad protections for swap
14 agreements, and the goals that are defined are certainty for
15 the markets and to protect liquidity. The legislative history
16 shows the intent is to insulate entire markets from the effects
17 of bankruptcy. It shows a concern that nondebtors might
18 otherwise be subjected to a stay for an extended period of
19 time. Through a series of amendments, including 2005
20 amendments, Congress extended the scope. They confirmed the
21 right to recover from pledged collateral.

22 Now, is BNY here as a swap participant? Your Honor,
23 we are not a mere lender. They didn't sue Saphir; they sued
24 BNY. And that's significant. We're in this litigation
25 because, under the documents, the issuers are rights are

1 assigned to the trustee and exercised by the trustee.

2 The committee spoke of the noteholders not being a
3 party. We are not the noteholders. The issuer, under the
4 principal trust deed, cannot exercise rights independently.
5 Under the supplemental trust deed, all of the rights are
6 exercised by us, typically with direction indemnification. And
7 LBSF is as party to the supplemental trust deed. And in that,
8 it acknowledges our rights.

9 Let's focus, then, in on Sections 560 and on
10 362(b)(17). 560 authorizes termination and liquidation. And
11 "liquidation" the word, contemplates payment. 560 authorizes
12 netting out termination values of a payment amount arising in
13 connection with liquidation. The code clearly anticipates
14 payment in accordance with the documents. 560 provides for
15 liquidation pursuant to normal business practices. It is not
16 normal for the non-defaulting party to see its collateral
17 liquidated and then held onto for some indefinite period of
18 time by the debtor. Payment is what's normal; payment in
19 accordance with contract priorities is the normal practice.
20 Payment is hardly ancillary here. It's an essential part of
21 the liquidation process. This is a functional approach that
22 Congress has taken. If an action is part of the liquidation
23 process, it's within the safe harbor.

24 Let's switch, then, to Section 362. 362(b)(17)
25 provides, "The stay does not bar exercise of any contractual

1 rights as defined in Section 560 under any security agreement
2 or arrangement forming a part of or related to any swap
3 agreement." The contractual rights defined in 560 are not
4 limited to termination or liquidation. To the contrary, the
5 statute says they include rights existing under the common law,
6 under law merchant, under normal business practice. Security
7 arrangement here clearly includes the waterfall flip. It
8 clearly is part of or related to a swap agreement within
9 362(b)(17). And this statute also extends not just to setoff
10 but to self-help foreclosure on pledged collateral. The house
11 report makes that very clear. It doesn't apply only to
12 transactions involving ipso facto clauses. And indeed, there's
13 no room to read 365(e)(1) so as to limit the scope of
14 362(b)(17). That would, in effect, impose a stay where
15 Congress has said there should be an exception to the stay. It
16 would make it superfluous. So, Your Honor, reading 560 and 362
17 together, I think leaves no doubt Congress intended that final
18 settlements, distributions in accordance with contract
19 priorities, be exempt.

20 Now, Lehman argues for narrow construction that seeks
21 to impose limits not found in the statute or in the legislative
22 history. There really is no one testifying that says this has
23 to be limited. Sure, the statute has to be read in accordance
24 with its terms, but there was nothing in congressional reports
25 or testimony that says this should be construed narrowly. To

1 the contrary, witnesses and particularly the Congressional
2 reports say these ought to be broad protections. They are to
3 include the right to foreclose on and distribute pledged
4 collateral.

5 Even without looking at 362(b)(17) the notion that
6 560 would permit only calculation of the amount owed and not
7 payment makes no sense. It would let the debtor just hold the
8 collateral hostage. 365(e) is not, as Lehman says, a bedrock
9 principle that has to control in every instance. Protection of
10 financial markets is not something new. As we note in our
11 brief, it dates back to the Chandler Act. And Lehman cannot
12 ignore the deliberate creation of these safe harbors. It
13 cannot subordinate them where Congress has had unqualified
14 language. And again, a general prohibition has to yield to a
15 specific statutory exception.

16 What about the goals of liquidity? Well, liquidity
17 requires immediate access to the proceeds. The reading that's
18 offered here by Lehman would result in illiquidity. And it
19 would result in uncertainty with regard to timing, had Congress
20 intended to impose such material limitations. Trapping the
21 collateral, leaving a contract terminated or liquidated, yet
22 somehow in some kind of limbo, somehow it would have said that
23 in twenty years of expanding safe harbors. If there's any
24 doubt as to what's within the scope of 560, I think it's
25 dispelled by the stay exceptions in 362(b)(17) and 362(o).

1 Now, Lehman has observed that 560 refers to
2 termination, it doesn't refer to modification. They note that
3 365(e)(1) deals with termination and modification. And they
4 say aha, you're talking about a modification here;
5 modifications don't come within Section 560. Well, again, the
6 Court of Appeal says under English law, nothing's been
7 modified. But even without that, the inclusion of modification
8 in Section 560 would make no sense. A modified contract is an
9 ongoing, functioning contractual relationship. But if there's
10 termination or liquidation, there's nothing left to modify.
11 There's no ongoing relationship.

12 If you look at how Congress has dealt with
13 contractual terminations elsewhere -- or contractual
14 modifications elsewhere, such as in Section 1113, if there's a
15 modification, it modifies what is an ongoing, functioning
16 contract. Under 1113, if it's not modified, it's rejected.
17 The relationship comes to an end.

18 A last point on safe harbors. They suggest equity
19 should step in to try and limit the application, limit the
20 scope of safe harbors. The documents here, Your Honor, are to
21 be enforced in accordance with English law establishing
22 property rights and the Code. The Code does not have equitable
23 powers to act in a manner inconsistent with the Code, to try
24 and limit things where Congress has not created limits.

25 Now, we suggested that if there's any inequity here,

1 it's LBSF attempting to use bankruptcy to modify the
2 obligations that arose in a product that it sold based on a
3 promise of protection against insolvency. Now, that is in some
4 ways an editorial, but it's important, because it does tie into
5 the concept that Lehman's position would result in increased
6 risk, increased uncertainty. It would result in delay and
7 higher costs. Given the role of derivatives of swap agreements
8 in today's economy, that clearly would be at odds with the
9 Congressional intent to ensure certainty and to protect
10 liquidity in the marketplace. To deny priority would chill the
11 derivative markets. It would, as the rating agencies have
12 said, result in a substantial change. So we think the goals of
13 the safe harbors are best served by enforcing the priority
14 provisions.

15 Let me address a few additional issues, quickly. Are
16 there genuine issues of material fact? We haven't pointed to
17 any, but of course, if the Court thinks that there are genuine
18 issues of material fact, that would be a basis to deny summary
19 judgment.

20 What about comity and coordination if Lehman
21 prevails? Well, this Court has recognized comity early on.
22 You recognized it again today. What happens if Lehman wins and
23 if we have conflicting decisions? We said that there should
24 not be the ability to enforce any decision until there has been
25 further coordination. And based on the filings that were made

1 last week in the High Court by LBSF, I think they agreed.
2 You've now received the High Court's letter. Looking to what
3 Lehman filed last week in the High Court, they say they're only
4 looking for an order declaring the effect of bankruptcy law,
5 they're not looking for an order that would require BNY to take
6 any action. To quote: "No order is sought at this stage
7 requiring BNY, for example, to distribute the collateral to
8 LBSF. Further orders from the US Bankruptcy Court would be
9 required for this to occur, and none are presently sought." I
10 think that they agree that if they prevail, there has to be
11 something more, there has to be what was referred to as an
12 enforcement stage. I think we agree that there would be an
13 opportunity for briefing, if appropriate, for submission of
14 evidence. That's not before you today. But it could be if
15 Lehman prevailed on summary judgment.

16 On a related point, there were references in the High
17 Court's decision and indeed in the colloquy with this Court in
18 connection with the motion to dismiss, relative an application
19 being made under the UNCA (ph.) Trial Model Law to the High
20 Court. There was agreement that it would be appropriate to go
21 there. Now, an application has been filed. But the
22 application only seeks a stay with regard to any other actions
23 similar to what Perpetual did that might be filed. They're not
24 seeking any relief in the High Court now tied to this action.
25 Presumably they're saying if they prevail on summary judgment

1 here, then they'll take it up. I mention that only because it
2 confirms that what they're looking for today is, and should be
3 limited to, declaratory relief.

4 Your Honor, I want to touch on one final issue.
5 Perpetual has never given us indemnification. I don't think
6 that comes as any surprise. Why is this relevant? Well, I
7 started out and I said that Butner is the elephant in the room.
8 And Aflac is the duck that's not in the room today. This Court
9 found that we are an adequate representative for Perpetual,
10 because if we were ardently advocating on behalf of Aflac, we
11 would be ardently advocating on behalf of Perpetual. I was
12 interested to hear the suggestion that Perpetual may be subject
13 to U.S. jurisdiction. But for purposes of today, Your Honor, I
14 think it's clear that since the motion to dismiss was denied,
15 we have been zealous in defending this case; we have been
16 zealous in undertaking the role that has been assigned to us
17 here.

18 But what is the rationale for treating us as an
19 adequate representative if Aflac is not here now? It is a
20 jurisdictional issue. We raised the jurisdictional issue as an
21 affirmative defense and I believe jurisdictional issues can be
22 raised at any time. To the extent there is a jurisdictional
23 issue here, we believe the Court should consider whether the
24 requirements of Rule 19 and comity have been met. Thank you,
25 Your Honor.

1 THE COURT: Thank you, Mr. Schaffer. Anything
2 further?

3 MR. MILLER: Briefly. Your Honor, Ralph Miller. And
4 I will try to be brief. I think I'll start in inverse order.

5 First, it is true that you have a request from Mr.
6 Justice Henderson asking that the Court only deal with
7 declaratory relief. And at this point, LBSF believes that is
8 all that needs to be dealt with by the Court as a result of
9 this proceeding, and agrees that coordination would be
10 appropriate if the Court determines, as we hope you will, that
11 declaratory relief is appropriate. So we think that that is
12 not an issue where collusion is inherent and is going to occur.

13 I wanted to talk for just a moment about some safe
14 harbor language that Mr. Schaffer conveniently ignores which is
15 present in both Section 560 and 362(b)(17); and that is the
16 rather elaborate discussion of offset or net-out which would
17 not be necessary if liquidation, termination or acceleration
18 included payment. This is a very narrow subset of the payment
19 calculation. And as we've shown, the legislative history
20 indicated that the concern was about people being able to
21 calculate what was due and know where they were. And that
22 required liquidation, termination or acceleration, which is
23 also the language used in other safe harbors, such as Section
24 555.

25 It did not include the final settling up. And one

1 important point is that this Court doesn't have any parties in
2 this period of time they have come before, with all these 300
3 contracts, saying we have to have our money right now. This is
4 sort of the dog that did not bark. And that is, there has been
5 no party that has claimed such incredible disruption to the
6 swap market that they have to come in and get their money right
7 now. The liquidation, termination, acceleration allows people
8 to calculate to know where they are, to close their books. And
9 at that point, sorting out who's paid what is really a
10 different process.

11 If you look at the language in 560 it goes on. It
12 talks about "the exercise of any contractual right of any swap
13 participant or financial participant to cause the liquidation,
14 termination or acceleration of one or more swap agreements
15 because of a condition of the kind specified in 365(e)(1) of
16 this Title, or to offset or net-out any termination values or
17 payment amounts arising under or in connection with the
18 termination, liquidation or acceleration of one or more swap
19 agreements, shall not be stayed, avoided or otherwise limited."

20 Now, there was no need for that whole "or" clause if
21 liquidation, termination or acceleration was intended to
22 include dealing with the calculation of termination values or
23 payment amounts, because that's just a subset of the broader
24 category. That same language is present in 362(b)(17) where
25 Congress again repeats under subsection (a) of this Section, of

1 "the exercise by a swap participant or financial participant of
2 any contractual right as defined in Section 560," again it
3 refers back to 560, "under any security agreement or agreement
4 or other credit enhancement forming a part of or related to a
5 swap agreement or of any contractual right as defined in
6 Section 560 to offset or net-out any termination value, payment
7 amount or other transfer obligation arising under or in
8 connection with one or more such agreements."

9 So again, Congress didn't need all that extra
10 language about offset or net-out if intended for the phrase
11 "liquidation, termination or acceleration" to include the whole
12 payment process. This is actually a subset of the payment
13 process, and we think that's a compelling reason, in both
14 sections, why 560 should be narrowly limited.

15 With regard to the argument that the Butner case is a
16 resolution, the Butner case is actually somewhat circular in
17 the sense that it sets the question but it doesn't answer it.
18 If the Court decides that there were no rights at the
19 beginning, then obviously there are no rights to deal with.
20 The question is, were there rights or weren't there rights.
21 And we believe that the structure of the documents makes it
22 clear that until a termination occurred, which is something
23 this Court may be more familiar with than virtually any other
24 court in the universe, because you've dealt with more of those,
25 we think, than others, that the termination triggers a whole

1 series of events. And until that trigger occurs, the
2 transaction is going on unterminated. It's an open
3 transaction. It's a completely different thing. And it was
4 when the termination occurred on December 1st, that these
5 shifts in rights occurred. They did not occur automatically.
6 It was not an automatic provision.

7 But furthermore, there is this overlay of ipso facto
8 reaching back to the commencement of a case. And the point
9 that Mr. Schaffer makes where he says well, the English court
10 said those rights weren't there; of course the English court
11 would say the rights were not there, because the English court
12 would be looking in English law that doesn't have the ipso
13 facto doctrine. We believe that in the US, the rights of a
14 party at the beginning of its case are the rights under federal
15 and state law, the layering of those things together. And if
16 the bankruptcy had protected -- if the bankruptcy law had
17 protected the right of a party at the time it goes into
18 bankruptcy, it's still got that right.

19 And so we believe, as we've explained, that the
20 commencement of a case under this title, which would be the
21 LBHI Chapter 11 filing, was the alleged cause of this loss of
22 rights by LBSF. We think it's invalid, and therefore the
23 rights were still there when LBSF filed. So it really doesn't
24 make any difference which of the two filings you look at. It
25 was a bankruptcy filing that triggered the ipso facto clauses

1 here.

2 And the English -- the analysis Mr. Schaffer has
3 presented would really only make sense if you assume that a
4 non-Chapter 11 cause was what changed the property rights.
5 Then you wouldn't have this need to apply ipso facto analysis
6 to what happened with LBHI.

7 THE COURT: Mr. Miller, how does the LBHI filing on
8 September 15 tie into, if it does at all, the termination on
9 December 1? And how does it tie into rights that LBSF is
10 articulating today?

11 MR. MILLER: Well, there are two parts to that answer
12 I believe, Your Honor. First of all, LBHI was a so-called
13 credit support provider which is, in effect, a guarantor. And
14 the way the ISDA are set up a default occurs when a swap
15 counterparty or its credit support provider go into Chapter 11
16 or other insolvency filing. So the tie in here is that the
17 event of default could have been the LBHI filing. Another
18 event of default occurred when LBSF filed.

19 They tie into the termination and what LBSF is saying
20 is because the termination notice here occurred after LBSF
21 filed and the early termination date was after LBSF filed. So
22 on the date of its termination -- I'm sorry; on the date of its
23 filing for Chapter 11 no termination had occurred. And it's
24 significant that that termination notice specified the LBSF
25 filing as the relevant event of default that gave rise to the

1 termination. In other words, it was selected.

2 In effect, the event of default arising from LBHI was
3 waived to the extent that it was not triggered. There are some
4 factual patters out here, Your Honor, that are different where
5 some U.S. parties sent their notice on, say, September the 18th
6 and designated that day as the early termination day. And if
7 you had that you'd have a different factual pattern because
8 then you would have -- and it might still be, by the way, an
9 ipso facto violation but you would not have the clarity that we
10 have here of a termination notice that comes later.

11 Now the way that all this ties together is condition
12 44 only operates after termination, it's and early redemption
13 provision. So if you don't have the termination you never go
14 to condition 44. You never do that calculation, one way or
15 another. And we say, under those circumstances, you can't
16 operate until the termination occurs. So you had two months
17 when condition 44 was encoded, if you will, and was then
18 triggered by the termination notice. And there's a general
19 principal, under 541, and I want to talk about it, policy, that
20 rights that could have been terminated before bankruptcy were
21 not are still there. I mean, we see a lot of case law, and we
22 talked about some of this, where there was a right to terminate
23 a contract, for example, but it hadn't been terminated and the
24 bankruptcy occurs, that contract is frozen, it's preserved at
25 that point. The termination can't be sent later.

1 If that termination was sent before the bankruptcy
2 and the contract was gone, under the applicable law, assuming
3 that that termination, by the way, was not based on a
4 bankruptcy. Assuming it's not itself an ipso facto violation,
5 it was based on nonpayment or some other appropriate cause,
6 then it's gone as of the date that the bankruptcy filing
7 occurs. So that is the -- we think that it's critical here
8 that this termination notice came almost two months later.

9 Now Your Honor, it's important to note that there's
10 been no consideration, the legislative history, the case law or
11 any other materials here that the safe harbors were ever
12 considered in relation to waterfall provisions or these complex
13 provisions. This SPV structure really arose after the safe
14 harbors were passed. So it is important to understand that
15 you're dealing with an issue of first impression.

16 And I want to talk, just very briefly about the
17 policy here. We believe that the United States bankruptcy
18 system is particularly effective because it does preserve all
19 the rights necessary to operate a business. And that includes
20 contingent rights, it includes conditional rights, it includes
21 security interest, it includes all the things necessary for a
22 business to survive. And that's what the ipso facto doctrine
23 is all about. We think it is a pervasive and important policy.
24 Very different, we believe, from the info-cit under English law
25 which is much more designed, we believe, for secured creditors,

1 particularly to get their rights out and, if necessary, a
2 liquidation to occur. The reorganization emphasis of U.S.
3 bankruptcy law, we think, requires the broadest possible
4 interpretation of the ipso facto doctrine, one of the reasons
5 that commencement of a case under this title is the right
6 interpretation and that leads to a narrow reading, we believe,
7 of the safe harbors.

8 The safe harbors were to protect specific markets and
9 unless that -- there's a demonstrable benefit and there is not
10 a demonstrable benefit here to broadening those safe harbors,
11 we think that they interfere with the very fabric of the
12 reorganization system in the country. And that's one of the
13 reasons that we think this case is important for the message
14 that it's going to send.

15 Working my way back, briefly, to some of the other
16 points that Mr. Schaffer made, I think we have already covered
17 and dealt with the whole subordination discussion. It is quite
18 clear that you can't read the subordination provision, 510, as
19 if it were a safe harbor and just the additional language that
20 I read about the Court not being able to stay or prevent it
21 from going forward, all that is missing because it's really not
22 designed, we think, to invalidate other provisions of the code
23 that were passed at the same time.

24 I did want to conclude, I think Your Honor, with a
25 quote, by the way there is a comment here someone handed me

1 that it is irrelevant that AFLAC is not here because BNY joined
2 all of AFLAC's filings and it adapted those to its own purposes
3 and it does rely on the arguments that are present in those
4 earlier filings.

5 Your Honor, I think there's a very insightful comment
6 at the end of the Court of Appeals judgment that really
7 summarizes the difference between what was before the Court in
8 England and what's before this Court. In paragraph 174 the
9 Court's statement is, "There's nothing in the English
10 authorities which supports the extension of the anti-
11 deprivation principle to encompass transactions which do not
12 alter the property of the insolvent company in the asset in
13 question. And it would require, I think, a significant
14 amendment to the provisions of the insolvency act before such
15 transactions could be struck down. Although such provisions
16 exist in other jurisdictions, they are not yet part of the
17 English statutory regime."

18 The point, I think Your Honor, actually is that the
19 United States Bankruptcy Code is on the leading edge of
20 development and recognition of the protection of the rights
21 necessary for reorganization. And the statutory system, which
22 was adopted in the code and which is -- has been persistently
23 reenacted and preserved by Congress with very limited
24 exceptions, is what's necessary for reorganization and for the
25 Chapter 11 process to work.

1 England, frankly, is not at that stage of
2 progression. It was dealing with a common law doctrine and a
3 lot of this opinion is making the point, as our courts often
4 do, Congress will have to deal with this. They're saying this
5 is a statutory issue, the United States Congress has dealt with
6 it, it had not been dealt with on a legislative basis there.

7 To try to limit what Congress has already done
8 because, frankly, England is not at the stage of progression
9 that this country has reached, would be a great mistake and
10 would be a step backward. We urge the Court to give a broad
11 interpretation to the ipso facto doctrine and the valuable
12 protections that it grants and to issue the declaratory
13 judgment that these provisions do violate Sections 365 and 541.

14 Thank you, Your Honor.

15 THE COURT: Thank you. Thank you for the excellent
16 argument presented by both sides. It's an important issue.
17 I'm not deciding it from the bench today and I will take it
18 under advisement.

19 We have a fairly crowded courtroom still, suggesting
20 that people are either interested in the argument or afraid to
21 leave. To the extent there's anybody who would like to leave
22 now, having sat through this, we're going to take about a five
23 minute break and then I'll get to the remainder of the agenda.
24 We're adjourned for five minutes.

25 MR. MILLER: Thank you, Your Honor.

1 (Recess from 3:56 p.m. until 4:09 p.m.)

2 THE COURT: Please be seated. Mr. Slack, good
3 afternoon.

4 MR. SLACK: Good afternoon, Your Honor. Richard
5 Slack from Weil Gotshal for the debtor. The next two matters
6 on the agenda, Your Honor, this afternoon both involve the
7 Board of Education of Chicago. The first is a motion to compel
8 performance under an executory contract and the second, Your
9 Honor, is a motion to dismiss the adversary proceeding of
10 Chicago Board.

11 The two motions that we make are obviously related in
12 that in some ways they're the flip side of one another. The
13 motion to compel seeks, Your Honor, to ask that the Board of
14 Chicago, which I guess is easiest referred to as the Chicago
15 Board instead of the Board of Education for the City of Chicago
16 oral argument. But the Chicago Board has an executory contract
17 and like the Metavante case, Your Honor, which we spent a fair
18 amount of time with, we contend that the Chicago Board should
19 be forced to perform during the gap period, so to speak.

20 The motion to dismiss is related in that the
21 adversary proceeding seeks a declaration that they do not have
22 to perform, and there's a number of counts that we'll get to.
23 I'm going to address the motion to compel first, Your Honor.
24 And I think it makes sense to deal with these both together, so
25 I'll be speaking to both of them as we go forward.

1 THE COURT: Is there any objection to handling these
2 together?

3 MR. FRIEDMAN: None, Your Honor.

4 THE COURT: Fine. That's what we'll do.

5 MR. SLACK: Your Honor, the facts of the motion to
6 compel are very similar to those presented to the Court in the
7 Metavante matter. The type of swap at issue is also an
8 interest rate swap under the terms of an instant master and
9 that's the same type of swap that was involved in the Metavante
10 situation.

11 The Chicago Board and LBSF entered into the interest
12 rate swap in 2003 and generally under that agreement LBSF
13 agreed to make monthly payments based on a floating interest
14 rate on a notional amount of ninety-five million. And the
15 Chicago Board agreed to make semi-annual payments based on a
16 fixed interest rate of 3.771 percent on the same notional
17 amount.

18 Like in Metavante, Your Honor, this swap is heavily
19 in the money for LBSF. And just to give you an order of
20 magnitude, LBSF's payment in April, May and June of 2009, the
21 monthly payments, would have been about twenty or 30,000
22 dollars a month for a total of about 120 to 180,000 over a six
23 month period. While the Chicago Board owed a net payment of
24 about 1.7 million to LBSF. So this swap is heavily in the
25 money to LBSF.

1 Like in Metavante, Your Honor, both parties performed
2 pre-bankruptcy. So there was never an issue up until the
3 bankruptcy as to performance. Once the bankruptcy hit, Your
4 Honor, LBSF did not make monthly payments and in March 2009
5 when Chicago Board semi-annual payment obligation became due,
6 Chicago Board failed to pay even though it owed LBSF more than
7 a million dollars, even considering the netting which is
8 allowed under the agreement. In other words, even though these
9 payments are not due at the same time, the ISDA master, in
10 2(c), allows the Chicago Board the ability to net these
11 payments out that it needs to pay.

12 Interestingly Your Honor, just as a point of fact, in
13 September 2009 Chicago Board did make a payment to LBSF, that
14 was one of its payments it was required to make, totaling about
15 1.8 million. We've since been told that that was a mistake but
16 the payment was made. Chicago Board still owes LBSF
17 approximately 1.1 million in principal payments and another
18 100,000 in default interest payments.

19 THE COURT: Have they asked for the money back?

20 MR. SLACK: They have, Your Honor.

21 THE COURT: And what have you said?

22 MR. SLACK: No.

23 THE COURT: Did they ask in a nice way or did they
24 send you a nasty demand letter?

25 MR. SLACK: I wouldn't want to characterize it. It

1 was matter of fact, Your Honor.

2 THE COURT: It was a matter of fact give us the money
3 back?

4 MR. SLACK: Yes.

5 THE COURT: We made a mistake.

6 MR. SLACK: Essentially that's right, Your Honor.

7 THE COURT: Okay. This is an aspect of the case I
8 didn't know until now.

9 MR. SLACK: Moreover, like in Metavante, had the
10 Board of Chicago wanted to preserve the actual terms of the
11 contract, it had options. It could have terminated immediately
12 pursuant to the applicable safe harbors and entered into a
13 replacement swap that would have replicated the trade with a
14 different counterparty. But the Board of Chicago didn't do
15 that and one of the things you hear in their papers, and it's a
16 difference that I'm going to talk about in a little more detail
17 in a minute, is that because their contract required LBSF to
18 make monthly payments, which they say are very important to
19 them in their papers, whereas Metavante was exactly on the same
20 date, they've said that that is a difference in the agreement.

21 But had that been a difference that was important, in
22 other words receiving the monthly payments, not only could they
23 have terminated immediately and got a replacement where they
24 get those monthly payments, some months ago LBSF found a party,
25 who was a significant derivative player, to whom they could

1 have assigned the contract. And this too would have assured
2 that the Chicago Board was protected in the event that these
3 monthly payments were actually important. But Chicago Board
4 refused, insisting that it did not have to pay the catch up
5 payments to the assignment and therefore that assignment was
6 not able to go forward.

7 Now, all in all, Your Honor, because the matter we
8 say is very much like the situation like Metavante, and this
9 Court has had, and already heard significant argument,
10 briefing, on those issues, what I wanted to do was focus not on
11 what was the same but what was different. And the one
12 different that's raised is the one that I just mentioned, which
13 is the fact of the payments being monthly that LBSF is required
14 to make as opposed to in Metavante where they were on the exact
15 same time.

16 Your Honor, we suggest that that factual difference
17 makes no difference under the bankruptcy law. Now as this
18 Court recognized in Metavante, during the gap period between
19 commencement of a bankruptcy case and the time when a debtor
20 determines whether to assume or reject, the counterparty must
21 perform but the debtor need not. It's not enforceable against
22 the debtor even if the debtor has not performed under the
23 contract, which was the case in both Metavante and here.

24 Now this doesn't mean that the nondebtor has to
25 perform without compensation. The nondebtor party is entitled

1 to the value of the services provided to the debtor. Now in
2 the Bildisco case, which again we -- this Court is well aware
3 of, what that court says was if the debtor in possession elects
4 to continue to receive benefits from the other party to an
5 executory contract pending a decision to reject or assume the
6 contract, the debtor in possession is obligated to pay for the
7 reasonable value of those services which, depending on the
8 circumstances of a particular contract, may be what is
9 specified in the contract.

10 And the Dewey (ph.) case which both sides cite makes
11 it very clear and there are other cases that we cite in our
12 brief, that the fact that you have a contract doesn't mean that
13 the debtor has to perform under it. It says -- in that case
14 the quote was, "U.S. Postal Service argues that when a debtor
15 forces the nondebtor party to continue to perform, both parties
16 are bound by the terms of the contract including, in this case,
17 the contractual recoupment provisions. As Bildisco makes
18 clear, that is not the law."

19 So what that means, Your Honor, is that what the
20 Chicago Board is entitled to receive here is not LBSF's
21 performance under the contract but it is entitled to the value
22 of the services that it renders after it renders that. And
23 typically what the cases have said is that Chicago Board would
24 be entitled if it wasn't paid otherwise to a priority post-
25 petition claim.

1 Now what the Chicago Board suggests is that there is
2 somehow an exception to the court's ruling in Metavante and to
3 the court's decision -- the Supreme Court's decision in
4 Bildisco, that where the debtor doesn't perform, in other words
5 doesn't make monthly payments in this case, that they have a
6 right not to perform. That essentially the performance of the
7 debtor can be a condition to their performance.

8 Now there's not a single case that's cited by the
9 Chicago Board and none that we have found that requires a
10 debtor to perform under the terms of a contract as a condition
11 to the performance by the counterparty. In fact, it's
12 completely opposite what Bildisco says, which is that if you
13 are a counterparty you must perform, the debtor need not
14 perform. And if you don't get paid for it you can get the
15 value of those services by coming back to the court and getting
16 the value.

17 Now what do we say should happen here? What we say
18 should happen here, Your Honor, is that the nondebtor, Chicago
19 Board, should simply perform. And if they perform by paying
20 every six months the contract itself, which is 2(c) of the
21 master agreement, section 2(c), will allow them to net out the
22 payments exactly like Metavante so that every six months they
23 will get the benefit of the performance by LBSF in full. And
24 so there will not be a situation where they will be performing
25 and will not have the benefit of LBSF's performance because

1 they will, by the netting provisions in the master, have gotten
2 the benefit of what they're entitled to.

3 And more importantly, Your Honor, what they
4 essentially are saying here is that LBSF has to perform first.
5 And again, there's nothing that requires the debtor to perform
6 as a condition to the performance of the counterparty.

7 With respect to a number of cases we cite in our
8 briefs that talk about the fact that this -- that the proper
9 measure of what a counterparty is entitled to is a post-
10 petition administrative claim. Your Honor, the Continental
11 Energy case from Pennsylvania from 1995 talks about that as
12 well.

13 THE COURT: Is it your basic position that but for
14 the monthly payment feature that this is, for all practical
15 purposes, the situation indistinguishable from Metavante?

16 MR. SLACK: Yes, Your Honor. That is what we believe
17 to be the case. In other words, the master agreement is the
18 same; the defaults under the master agreement are the same.
19 The language of the defaults under the master agreement are all
20 the same. The only issue that's raised that's really a
21 distinguishing feature of the transaction is this monthly
22 versus semiannual payment dates.

23 So Your Honor with respect to the motion to compel,
24 it's our view that Chicago Board should be required to perform.
25 They're going to get the full benefit of LBSF performance and

1 we find it indistinguishable from Metavante.

2 With respect to the motion to dismiss, Your Honor,
3 much of what I just said goes to the counts. But I would like
4 to go through the counts individually, very briefly. The first
5 count seeks a declaratory judgment that the events of default
6 under 2(a)(3), and again these are the exact same defaults that
7 the contract provides in Metavante, are enforceable and not
8 ipso facto provisions.

9 The second count seeks a declaratory judgment that
10 LBSF cannot assume or assign the interest rate swap because
11 those same defaults are not capable of being cured. And the
12 third count seeks a declaratory judgment that even if the
13 assumption and assignment of the swap agreement is permissible,
14 then the board is not required to pay the amounts that have
15 accrued, essentially the back payments. As I said before,
16 there was a potential assignment that was scuttled when the
17 Chicago Board refused to pay the, sort of, catch up payments.
18 And I think this count goes to that.

19 With respect to the first count, Your Honor, I think
20 the issue is squarely what we just discussed with respect to
21 Metavante so I'm not going to dwell on that unless there are
22 questions from the Court.

23 With respect to the second one, Your Honor, which is
24 the count that relates to whether this contract could be
25 assumed and assigned, the predicate for that is the same. In

1 other words, they're saying because there were these defaults
2 that cannot be cured because they're non-monetary defaults,
3 that therefore this contract cannot be assumed and assigned.
4 As Your Honor is probably aware, where you have a contract
5 provision that is an unenforceable ipso facto clause, that
6 doesn't apply. And we've briefed that in our brief.

7 The second point, though, is a little different.
8 Count II's other fatal flaw is that it's not right. Count II
9 is premised on a hypothetical situation where they're saying
10 they don't have to assume or agree to an assumption and
11 assignment but there's no pending motion. And if there was a
12 pending motion the bankruptcy court would provide or the
13 bankruptcy laws would provide that they'd have a full
14 opportunity to object at that point.

15 Now while there was a consensual assignment that was
16 discussed, that's not the same thing. Obviously they would
17 have to agree to it, which they didn't do. So with respect to
18 Count II, it's not only invalid, we think, on its face but we
19 also think it's not right and can be dismissed on that basis.

20 Count III seeks a declaratory judgment that the
21 Chicago Board is not required to pay the amounts it currently
22 owes to LBSF, essentially these catch-up payments. Again, we
23 think that's completely resolved by the fact that these are in
24 fact ipso facto provisions 2(a)(3) then they do have to make
25 these catch up when you assume and assign.

1 So Your Honor, unless you have additional questions,
2 we ask that the motion to compel be granted and also that the
3 motion to dismiss the complaint as a matter of law be granted
4 in its entirety.

5 THE COURT: All right. Thank you.

6 MR. FRIEDMAN: Good afternoon, Your Honor. Jeff
7 Friedman from Katten Muchin Rosenman for the Board of Education
8 of the City of Chicago.

9 First, let me just clarify how payment came to be
10 made at the beginning of September, since it's pretty much an
11 embarrassment all around. Lehman, LBSF, sent a bill for the
12 September payment to Deutsche Bank who is an agent bank that
13 holds bank accounts for Board and would normally make a payment
14 that was authorized by the Board, without any authorization,
15 whatsoever from the Board they made the payment.

16 Interestingly, despite what Mr. Slack said about the
17 Board being able to recoup all of the payments that LBSF is
18 supposed to make over the six month period from the payment
19 that was made, LBSF's bill, sent on September 1st of 2009 or
20 August 30th of 2009, only deducted one month's payment, the
21 payment that was due in month six. And without authority,
22 Deutsche Bank made that payment. Deutsche Bank, as I
23 understand, requested it back and LBSF has refused to return
24 it. Those are the facts as I know them.

25 THE COURT: Okay. That's an interesting little

1 wrinkle, isn't it?

2 MR. FRIEDMAN: Let me deal with the motion to dismiss
3 first, because some of what Mr. Slack said I agree with and
4 some of it I don't.

5 I do, fundamentally, agree, and this complaint was
6 filed before Your Honor's decision in Metavante, that our Count
7 I is effectively the facts in Metavante. We took the position
8 that the LBHI filing and LBHI's insolvency excused payment by
9 the board. And we understand Your Honor's decision in
10 Metavante and we also note that in Count II that issue is not
11 before the Court in Metavante. Count II seeks a declaratory
12 judgment that because of those same defaults those are
13 incurable nonmonetary defaults and as a result the only way
14 that this contract can be assigned or assumed is with the
15 Board's consent.

16 We sort of have an idea of which way Your Honor may
17 lean on those arguments, but we respectfully persist in them,
18 if nothing else, to preserve the board's appellate rights.

19 I do want to briefly address the argument that was
20 made that since a guarantee of LBHI was sought because of
21 concerns over LBSF's financial condition, that a default based
22 on LBHI's insolvency is really just an LBSF financial condition
23 ipso facto provision.

24 We argued that this was too fast of an argument by the
25 debtors. The debtors didn't cite any case law for this theory.

1 The problem with that, Your Honor, is virtually every default
2 that's in an agreement with a party that has to perform
3 services that cost money, can be said to go to some concern
4 over the financial condition of that party, whether it's a
5 desire to get audited financial statements once a year, some
6 cross default provisions, a no lien provision, all of those, to
7 some degree, would in Lehman, be ipso facto clauses. And I
8 just think that's far too broad a reading and not supported by
9 any case law we could find. So we just don't think that's a
10 correct reading of the law. And we do think that LBHI's
11 insolvency, under 365(e)(1)(A) is different than a filing of a
12 case under 365(e)(1)(B), even taking arguendo that a case in
13 365(e)(1)(B) means any case including LBHI's case. If we're
14 going to go by a literal, plain reading of the statute, that
15 same plain reading in 365(e)(1)(A) talks about the insolvency
16 or financial condition of the debtor. And the debtor here is
17 clearly LBSF.

18 Again Your Honor, we're familiar with the Court's
19 decision in Metavante. I won't belabor these, we've raised the
20 issues in our pleadings and reserve our rights in respect of
21 that.

22 I do want to briefly deal with their rightness
23 argument. They cite Judge Gonzalez's opinion in In re Finney,
24 which is at 2007 WL 1574294, page 7, saying that the rightness
25 doctrine turns on whether there are nebulous future events so

1 contingent in nature that there is no certainty they will ever
2 occur.

3 Your Honor, there might be something to this argument
4 if literally on the day that they made it in their motion to
5 dismiss they didn't file a motion to compel performance of the
6 very contract they seem to value, which Mr. Slack agreed was
7 heavily in the money to LBSF. So the notion that at some point
8 they are not going to attempt to assume or assume and assign
9 this contract, I think is almost frivolous. So we do think
10 that this is ripe and it's fairly clear that this is going to
11 occur and that the Court is in a position to decide that issue.

12 As for Count III, Your Honor, which goes to the
13 Board's obligation to pay the back payments if and when LBSF
14 assumes the contract or assumes and assigns the contract, we
15 submit that the Board really can't be asked to cure in a
16 circumstance where LBSF effectively told the Board that it was
17 not going to perform the swap.

18 This contract, this swap, happens to be for an
19 exchange of cash but Your Honor supposed that this was, you
20 know, a widget supply contract where the board was supplying
21 widgets every month to LBSF and LBSF said we're not going to
22 pay for the widgets this month we're sort of out business,
23 don't really need the widgets. But we're going to hang on to
24 the contract if maybe someone in the future will want this
25 contract. So we'll get back to you.

1 Pretty clearly, we can't force LBSF to pay us for
2 widgets that it doesn't want on a supply contract. But I
3 think, just as fairly, we don't have to send them widgets we're
4 not going to get paid for. And that's, sort of, what happened
5 here. They could have said what we agree with is a relatively
6 nominal amount of money. They could have sent us 20,000
7 dollars a month and we would have paid them their million seven
8 in month six, but they chose not to do it despite its value.
9 And quite frankly, that's been one of the most puzzling aspects
10 of this entire thing to me, which is why, for 20,000 dollars a
11 month Lehman, which clearly had the money, made the calculated
12 decision not to pay. Because frankly, until noon yesterday,
13 there was nothing in a Lehman pleading that even suggested we
14 were entitled to anything in compensation for our performing
15 semiannually. Finally yesterday, at 11:56, they conceded that
16 we're entitled to the reasonable value of the services we
17 provide.

18 But again, this is an exchange of cash, ridiculously
19 in the money to Lehman, 20,000 dollars a month for six months
20 versus about a million-seven, semiannually from the Board. So
21 I don't think Lehman is seriously considering asking this Court
22 to somehow find that our million-seven semiannually isn't worth
23 their 120,000 dollars over a six month period. So this really
24 isn't about that.

25 What this is really about Your Honor, and at this

1 point this is effectively the motion to compel, is Lehman is
2 saying even though we didn't write the contract this way, and
3 thy clearly didn't write the contract this way, why don't you
4 lend us the 20,000 dollars a month and you can pay yourself at
5 the end of six months, without interest presumably. I mean,
6 there was no discussion of that in here. And that'll be the
7 same thing. But that's not what the Board bargained for and
8 that's not what Lehman's rights are.

9 While it may be that Lehman can say that there's an
10 administrative claim here and we can pay you at any time, we
11 had no idea that Lehman was performing until noon yesterday
12 when it said oh I guess you really are entitled to some value
13 here and we do expect it.

14 So it's sort of bizarre that they now want to say we
15 can afford to pay our professionals, we can afford to pay
16 everyone else but we'd like you to borrow -- we'd like you to
17 loan us the money for six months and then take it out of --
18 take it out of, on a net basis, what you would otherwise owe
19 us.

20 THE COURT: Well, how would the Board be hurt by that
21 arrangement?

22 MR. FRIEDMAN: Well, for one thing Your Honor, that's
23 not what the contract provides and there's no particular
24 reason --

25 THE COURT: Well, I mean contracts that secured

1 lenders make don't provide that they can be crammed in a
2 Chapter 11 plan by the indubitable equivalent of their claim,
3 but it can happen in bankruptcy. Why should that not happen
4 here?

5 MR. FRIEDMAN: Because that's simply not what anyone
6 bargained for. They bargained for monthly payments that were,
7 at the time -- remember, we happen to be in an unusual position
8 in the world of interest rates. When they entered into this
9 swap in 2004 LIBOR was not .24.

10 THE COURT: Well, are you saying that if Lehman were
11 to make the business decision to treat this contract in
12 accordance with its ordinary business terms and write a check
13 each month to the Chicago Board for 20,000 dollars or whatever
14 the right number is, just assume that's a placeholder for the
15 right number --

16 MR. FRIEDMAN: Uh-huh.

17 THE COURT: -- that that would really end the problem
18 and you would withdraw your complaint and you would not worry
19 about getting back the supplied funds because there would be
20 complete parallel performance on both sides as agreed
21 prepetition.

22 MR. FRIEDMAN: It would certainly end our issue going
23 forward, and I said that at the pretrial conference about a
24 month ago, that if Lehman wanted to make payments in accordance
25 with the contract we would be happy to perform and the Board

1 has always been prepared to do that.

2 As to the issue of retroactive application, I
3 honestly have to discuss that with my client. But, I mean,
4 certainly Count III of our complaint is inconsistent with the
5 notion that we have to go back now and perform when Lehman has
6 not performed for well over a year.

7 THE COURT: I'm just trying to hone in on what the
8 real issue is here.

9 MR. FRIEDMAN: Right.

10 THE COURT: And I'm having, frankly, a hard time
11 understanding why Lehman is making a point of not paying
12 something that seems to be so relatively trivial.

13 MR. FRIEDMAN: And Your Honor, that was thing,
14 frankly, when my partner in our Chicago office approached me to
15 do this motion. I said I don't understand, Lehman's not paying
16 you 20,000 dollars a month to get 1.7 million dollars every six
17 months. And I truly was puzzled by that and finally, in one of
18 the replies filed yesterday, Lehman explained why it wasn't
19 paying and I think Mr. Slack mentioned it here, that somehow we
20 wanted, you know -- Lehman was concerned that we wanted Lehman
21 to perform first. We simply wanted Lehman to perform in
22 accordance with the contract. Had they filed their petition
23 date and the first payment happened to be our semiannual
24 payment date, we would have performed first. All we wanted is
25 Lehman's performance.

1 But then he goes on to say is, you can't possibly
2 expose the estate to putting out 100,000 dollars, because on
3 month six you'd get -- we've always traditionally netted the
4 month six payment. But he couldn't possibly risk the estate
5 putting out a 100,000 dollars with the possibility that the
6 Board of Education of the City of Chicago might not perform, as
7 if somehow the Board was going to abscond to Cuba with the
8 100,000 dollars. We told the debtor all along that we would
9 perform if they paid and they just, sort of, adamantly said we
10 don't have to perform, Metavante, we don't have to perform, you
11 perform. And that's really been a serious roadblock optically
12 because, you know, not surprisingly, Your Honor, the board is a
13 somewhat political body and it's under scrutiny from the press
14 and from others and it's very sensitive to making sure that its
15 contractual obligations are fulfilled but that it gets the
16 performance it bargained for. And so if Lehman would perform
17 on a current basis, the board will perform on a current basis.

18 THE COURT: It sure seems like a fair offer to me.
19 Mr. Slack, why is Lehman unwilling to perform on a current
20 basis and make an afternoon's argument out of something that
21 appears not to be that big a deal.

22 MR. SLACK: Your Honor, when you look at any
23 particular one case and you look at 20,000 dollars and you say
24 why doesn't Lehman pay 20,000 dollars, if it were -- if we had
25 a one-off case, Your Honor, maybe that's something that could

1 be considered. But what you have here, Your Honor, is a large
2 number of counterparties. And frankly the issue is one of a
3 matter of law that Lehman is simply, not under the law,
4 required to perform to the terms of the contract. What the law
5 says is that the counterparty has to perform and in this case,
6 Your Honor, there really should be no issue with Lehman paying
7 out money in advance before the Board of Chicago performed.
8 Because they can, in self help, every six months without a
9 dollar coming out of the estate and without having to do any of
10 that, without setting the precedent that somehow Lehman's going
11 to perform in order to get performance --

12 THE COURT: It's not the worst concept, by the way.
13 It's not the worst concept in the context of mutual obligations
14 under a swap agreement that parties actually perform instead of
15 take the position well I'm in bankruptcy I don't have to.
16 That's the position you've taken and it's obviously the
17 position you should be taking under the circumstances because
18 you're representing a debtor in possession.

19 But I'm not at all moved by the notion that there's
20 some kind of principled way that you can not perform just
21 because you're in bankruptcy and that's going to affect your
22 ability to deal with other contracts that are like this under
23 the principles announced in Metavante.

24 I'm frankly troubled, as I look at this case from
25 today's perspective, that we are dealing with an entity that's

1 not a five plus billion dollar financial institution, which was
2 the case with Metavante. We're dealing with a political
3 organization that's charged with the education of the public
4 school children of the City of Chicago. And that's a somewhat
5 sympathetic counterparty, particularly if you have to pay taxes
6 in Chicago.

7 So I don't think this is the best-test case for you,
8 frankly.

9 MR. SLACK: Well, you don't always choose your cases,
10 Your Honor.

11 THE COURT: I know that. But you settle the ones you
12 don't want to present.

13 MR. SLACK: What you do sometimes, Your Honor, is you
14 take the cases as they come and you try to apply the law as
15 it --

16 THE COURT: As it's evolving.

17 MR. SLACK: -- sits on the books.

18 THE COURT: Right.

19 MR. SLACK: And Your Honor, I would tell you here we
20 agree with one piece, and I'm not sure we quite get all the way
21 with Your Honor, that if you had a situation where we didn't
22 have the ability to net, which we do here, and we have the
23 ability that -- you know, the Board of Chicago has the ability
24 to net on a regular basis, in other words, I would say Your
25 Honor, if we were coming to Your Honor and saying you know

1 what, they have to pay us and they have to pay us the full
2 amount they owe us, they can't net anything. And they can come
3 to Your Honor and make an administrative claim down the road,
4 and maybe it'll be a post-petition administrative claim. And
5 frankly, I think the law provides that that is what they're
6 entitled to. Frankly, I wouldn't be that comfortable getting
7 up here, Your Honor, and arguing that to you as well.

8 But this is not what I'm arguing. What I am arguing
9 today is that there are netting provisions which, in a very
10 short period, so that when this counterparty performs it
11 immediately, contemporaneously to its performance, gets the
12 benefit of our performance.

13 I not only don't think that's unreasonable, Your
14 Honor. I think under the Code it's actually a fairly generous
15 position and I'm frankly not embarrassed at all to tell Your
16 Honor I think that's the right position for the debtor and for
17 the Court.

18 Now one other point, Your Honor, I think it's
19 important because I don't want it to get lost in the discussion
20 about future performance, is the issue of whether the money is
21 owed in the past. If you recall, like in Metavante, there were
22 payments that had not been made and the motion to compel was
23 requiring not only forward payments but backwards payments.
24 And what I'm hearing is that regardless of what we would agree
25 to do going forward, the back payments are something that we're

1 not going to be in agreement on even if we agree going forward.
2 And I think in that sense, Your Honor, the motion to compel is
3 necessary here. And whether or not, and again I think it's the
4 whole body of law here that says whether it's post-petition or
5 prepetition, even if the debtor has defaulted, during this gap
6 period the counterparty must perform.

7 So that performance, though, as we said, can be a net
8 number. It should be a net number. We agree to a net number.
9 But the motion still is necessary, Your Honor.

10 THE COURT: Mr. Friedman, do you want to say a few
11 more words?

12 MR. FRIEDMAN: Yeah. Briefly, Your Honor. Without
13 talking to my client I'm just not in a position to tell the
14 Court that we're prepared, assuming Lehman pays on a current
15 basis going forward, that will immediately cure the arrearage
16 because as I understand it, and I'm frankly not in the day-to-
17 day negotiations so I don't vouch that this is perfectly
18 accurate, but as I understand it there was a request by Lehman
19 for default rate interest for the back period. Because I would
20 certainly recommend to the Board to get this done, assuming
21 Lehman pays going forward, that it pay the net amount but in
22 essence without admitting it did anything wrong by just paying
23 whatever it owes on a net amount without some significant
24 interest factor.

25 I think Mr. Slack represented that the interest

1 amount was 100,000 dollars, I don't know if that's right or
2 wrong but I have no particular reason to doubt what he says.
3 So I'm happy to recommend that to my client, but without
4 talking to my client I'm not in a position to tell you --

5 THE COURT: That's fine. Here's what I think makes
6 some sense --

7 MR. FRIEDMAN: And I do want to make one reservation
8 of rights --

9 THE COURT: Okay.

10 MR. FRIEDMAN: -- Your Honor, just before you --

11 THE COURT: All rights are reserved.

12 MR. FRIEDMAN: Okay. Well, it has to do with the
13 fact that the Board -- it's been suggested that the Board has
14 waived its termination rights a la Metavante. And we do think
15 our facts are different. It's not before the Court now. We
16 think that there are compelling reasons that we are not
17 Metavante on the facts, but again, it's not before the Court,
18 we just reserve our rights on that.

19 THE COURT: Okay. The Metavante case is what it is
20 and I said what I said and I stand by what I said and that's
21 the rule of the case in effect. It applies to every
22 counterparty that fits into that rubric until such time as some
23 other court comes down with a different result. And I believe
24 that the result in Metavante is correct. And I'm encouraged to
25 hear somebody tell me in an earlier argument that even ISDA

1 seems to think it's correct.

2 However, this is a very public proceeding that
3 doesn't involve, in the context of the Lehman case, very much
4 money. But I'm sensitive to the fact that where the
5 counterparty is institutionally dedicated to the education of
6 children and collects taxes from, in this case, the citizens of
7 Chicago, I think this is not a very good test case. And I
8 think under the circumstances it would have been prudent,
9 although it's certainly not required, for Lehman, through its
10 advisors, to conclude that discretion is the better part of
11 valor and that, in this instance, working something out that
12 was acceptable to Lehman and also provided, and I use the term
13 advisedly, political cover for the board, would have been a
14 good thing. I think it's still possible. And I take Mr.
15 Friedman's comments as not a commitment that it's possible as
16 much as it is a statement that it might be. So I'm not going
17 to decide these motions quite yet, and suggest that they be
18 adjourned, for status conference purposes, to not the December
19 16th omnibus hearing but the one after that.

20 In the interval, I would recommend -- and I'm not
21 directing this, I'm simply making a recommendation -- that the
22 parties talk with each other about something that seems not to
23 be about economics, and it's not even about risk allocation.
24 It's an embarrassingly in-the-money for Lehman interest rate
25 swap that's embarrassingly out-of-the-money for the Chicago

1 board. Not that anybody did anything wrong; that's just the
2 way interest rates moved.

3 And for the board to be put in the embarrassing situation
4 of having the contract rewritten by operation of bankruptcy
5 law, which may be entirely permissible, and I'm not saying that
6 I might not do it in other circumstances. I know I have done
7 it in other circumstances.

8 I think this is an exceptional situation simply due to the
9 identity of our counterparty, and I suggest that they not be
10 treated like everybody else. They should get the benefit of
11 their bargain, not just a netting claim. Those are my thoughts
12 on this.

13 MR. FRIEDMAN: Your Honor, I'm going out of country
14 from the 10th to the 17th, and I understand the next -- the
15 omnibus hearing after the December one is January 13th. And I
16 was just wondering if you could adjust that date so that I
17 could be here.

18 THE COURT: Your schedule will be respected and this
19 can be listed for whenever you're in town.

20 MR. FRIEDMAN: Thank you, Your Honor.

21 MR. SLACK: Can I make one point, Your Honor?

22 THE COURT: Sure.

23 MR. SLACK: I think -- based on Your Honor's comments
24 I just think it's important that the Court knows that we have
25 been trying to work with the Chicago board and we have only

1 recently exchanged offers. We had hoped that this could be
2 concluded before this hearing, but it wasn't and, you know, no
3 fault to either party that we are in the position where we're
4 waiting for a response.

5 So I think we are in fact mindful of what Your Honor
6 said. We will be mindful going forward. We appreciate the
7 comments. But I wanted Your Honor to know that I don't think
8 we have been unmindful of exactly the comments and the
9 situation that Your Honor made today.

10 THE COURT: Okay. That's fine. Look, one of the
11 things I'm very sensitive to, and I know this from what goes on
12 in this courtroom and in many other courtrooms where there are
13 cases that are relatively high profile, this is not Vegas, what
14 happens here doesn't stay here. What happens here is almost
15 instantly on somebody's blog, picked up by Reuters or
16 Bloomberg, by local press, national press, global press, and
17 I'm sensitive to the fact that perception matters. I think we
18 should all be. Okay?

19 MR. SLACK: Thank you very much, Your Honor.

20 THE COURT: We have the Neuberger Berman matter.

21 MR. SLACK: Your Honor, the next matter is the
22 Neuberger Berman v. PNC Bank and Ardith Bronson from Weil
23 Gotshal is going to be handling this argument.

24 THE COURT: Okay.

25 MR. BROSTERMAN: I'll wait for everybody to assemble,

1 Your Honor.

2 THE COURT: Let's just take a moment.

3 (Pause)

4 MR. BROSTERMAN: Thank you, Your Honor. May it
5 please the Court, Melvin Brosterman from Stroock & Stroock &
6 Lavan on behalf of Neuberger Berman.

7 With the Court's permission I'd like to address not
8 only our motion for authorization on behalf of Neuberger Berman
9 to deposit funds with the clerk, but what I think is actually
10 the more important motion in these series of papers before the
11 Court today, which is the motion -- with Mr. Yorsz' permission
12 as well -- the motion of PNC to transfer the case to the
13 Western District of Pennsylvania because they're all inter-
14 related.

15 THE COURT: Before we start, I recall that at prior
16 adversary afternoons we had conversations about the possible
17 consensual resolution of this case tied, I thought, to
18 positions to be taken by Lehman. What happened?

19 MR. BROSTERMAN: We don't know. On November 10th,
20 after we were told, I was told, I believe Mr. Yorsz was told
21 the following. We were told by LBI that they would release
22 Neuberger Berman and allow it to pay the money to PNC. I was
23 told by LBCC that they consented, subject to the creditors'
24 committee --

25 MR. SLACK: Your Honor --

1 MR. BROSTERMAN: I was told --

2 MR. SLACK: -- I hate to object, but this was all
3 protected settlement discussions --

4 THE COURT: Okay, well, I --

5 MR. SLACK: -- and I --

6 MR. BROSTERMAN: The Court asked a question.

7 MR. SLACK: No, but you know what? There's
8 appropriate and there's not appropriate. This is not an
9 appropriate disclosure and we object to it, Your Honor.

10 THE COURT: Okay. Let's not disclose anything that
11 relates to settlement discussions of the parties. I was
12 simply trying to find out why we're litigating this and what
13 happened.

14 MR. BROSTERMAN: On November 10th we received a
15 submission that was filed with this Court by LBCC in which we
16 understood for the first time in the several months that there
17 were hearings before this Court that there would not be a
18 consent to a release of these monies by Neuberger Berman to
19 PNC. So -- and --

20 THE COURT: Okay. Let me --

21 MR. BROSTERMAN: That's the short answer.

22 THE COURT: Without going, then, into the details of
23 this, is this now a piece of active litigation that's no longer
24 capable of being resolved by the reasonable conduct of the
25 parties acting reasonably?

1 MR. YORSZ: Your Honor, It's Stan Yorsz. I would
2 certainly hope we could still reasonably resolve this. But I
3 was before the Court on two prior occasions --

4 THE COURT: Yes.

5 MR. YORSZ: -- and I was extremely hopeful that we
6 would receive consents from all -- LBI and LBCC to resolve this
7 prior to this time, but we did not. When I address the Court
8 after Mr. Brosterman, I will suggest that we have seen nothing
9 in LBCC's papers to suggest that they have any interest in
10 this.

11 But no one can seem to come to grips with the idea
12 that there is no claim. And people, for some reason, just
13 don't want to sign off on what we believe is a settlement
14 agreement. I'm not sure why that is, still, frankly. But that
15 seems to be the case, which is why Mr. Brosterman and I believe
16 that if the case is going to be resolved, there is no
17 bankruptcy issue involved and it should in the Western District
18 of Pennsylvania where we already have a case involving PNC and
19 Neuberger Berman.

20 THE COURT: Okay. Look, we're not going to the
21 merits here. We will in a moment. I was simply trying to find
22 out how this opportunity to resolve this in a business-like way
23 slipped away. And I'm confirming, I suppose, by both the words
24 and the body language, that we're proceeding this afternoon, so
25 let's just do that. I read the papers and I've been familiar

1 with this matter since the summertime.

2 MR. BROSTERMAN: Your Honor, Neuberger Berman is a
3 stakeholder. Our only interest is in avoiding litigation in
4 two jurisdictions and is in avoiding the possibility that we
5 could end up with a judgment against us in the Western District
6 of Pennsylvania and a judgment against us before this Court.

7 THE COURT: You sound like BNY.

8 MR. BROSTERMAN: Yeah, right. Well, there's
9 something to be said for that. And our other interest, Your
10 Honor, which is why we did this the way we did it, is to try to
11 keep down our legal fees, our client's legal fees as much as
12 possible.

13 And for that reason when we appeared before Judge
14 McVerry -- me being Mr. Yorsz and myself back in April. It was
15 the last day of the Stanley Cup Playoffs, I know that only
16 because everybody in the streets of Pittsburgh had Penguins
17 jerseys on. But that when we appeared before him at the time,
18 I informed the Court that we didn't -- we couldn't get complete
19 relief before that Court because we had an automatic stay that
20 prevented us from proceeding against LBI and LBCC, that what we
21 would do is bring an interpleader action here. Mr. Yorsz
22 informed the District Court that he would move to transfer that
23 interpleader here, and thereby giving one court the possibility
24 of complete jurisdiction.

25 My concern is that if we go forward here, given the

1 fact that the 28 U.S.C. 1335 which is the interpleader statute,
2 does allow a District Court to issue an injunction, what would
3 happen here procedurally is this. If Your Honor grants our
4 motion to deposit the funds, the next motion we would make is a
5 motion for an injunction preventing counsel, or rather PNC,
6 from proceeding in the Western District of Pennsylvania.

7 The problem with that is he will argue that while a
8 District Court could issue that injunction, that there's, in
9 his view, a question as to whether a bankruptcy court could
10 issue that injunction. So I run the risk, okay, and this
11 Court, I suppose, finds itself in a position where if it issues
12 an injunction there will be an appeal; if it doesn't issue an
13 injunction, following the deposit of funds I'm stuck here,
14 okay, I have an interpleader action here and I have an action
15 in the Western District of Pennsylvania.

16 So it is for that reason, since Ms. Bronson comes
17 from Boston to New York, it isn't terribly difficult to get
18 from Boston to Pittsburg. The hotel rooms are substantially
19 less expensive in Pittsburg. And nature abhors a vacuum and
20 lawyers are creatures of nature. The longer it takes for a
21 case to be resolved the more expensive it costs to resolve that
22 case.

23 This is a very busy court, maybe one of the busiest
24 courts in this country, certainly among the bankruptcy courts
25 and then some. The Western District of Pennsylvania has the

1 luxury of having a docket which is much less. We heard these
2 words from Judge McVerry. That case -- this case, if it is
3 transferred to the Western District of Pennsylvania, will be
4 resolved in no time flat, sixty days, ninety days. There is
5 very little, if any, discovery required, and a trial on the
6 merits could be done in -- if it takes two days, that's
7 probably a day too long.

8 So our interest and our only interest is avoiding
9 inconsistent results and reducing the legal fees. And I would
10 think in that respect our interest is completely consistent
11 with the interest of the estate. They want to keep down their
12 fees, they -- if they now claim that they, as of November 10th,
13 assert a claim to these monies, they will have the ability to
14 assert that before the federal District Court in the Western
15 District of Pennsylvania.

16 THE COURT: Well, there's an aspect of their papers,
17 though, that I think changes the analysis. It's not just a
18 question of the price of hotel rooms in Pittsburgh. It's -- by
19 the way, it's never a question of the price of hotel rooms in
20 Pittsburgh in terms of deciding the issues that are here.

21 Reading the papers that were filed on the 10th, the
22 position taken is that PNC has filed a proof of claim in
23 reference to the very same issues that are before the Court in
24 the Western District and here in reference to the interpleader
25 complaint. The proof of claim constitutes a submission of PNC

1 to the jurisdiction of this Court.

2 And I'm also told that it's not as simple as outlined
3 informally in that the intermediary -- I'll call Lehman the
4 financial intermediary for these purposes -- in the foreign
5 currency exchange transaction, the euro/dollar exchange that I
6 gather is the source of this monetized dispute, six million
7 plus U.S. dollars, was a transaction in which Lehman was in the
8 middle.

9 MR. BROSTERMAN: That's incorrect. They asserted,
10 but that's fundamentally incorrect. The facts are -- and
11 Lehman has not provided a confirmation of the transaction, and
12 there is one attached to the papers filed in the Western
13 District of Pennsylvania which are attached to these papers.
14 What occurred is the following. Lehman -- sorry, PNC and
15 Neuberger entered into a foreign currency exchange transaction
16 in which PNC is paying euros and Neuberger is paying dollars.
17 When the transaction settles, when it settles, okay, if the
18 euros were actually paid -- and by the way, the transaction is
19 entered into on August 2008, it was supposed to settle after
20 the bankruptcy in February 2009.

21 So on February 11, 2009, one of two things could have
22 occurred. Either PNC could have sent dollars to the account of
23 Neuberger which on the confirmation was listed as its account
24 at Lehman. It's a Neuberger account at Lehman. It could've
25 sent it to those. Or Neuberger could have said, because it was

1 the party to the transaction, send it to a different account.
2 Or what could've happened, which is usually typically what
3 happens -- and by the way, Neuberger would have had to send
4 dollars to PNC to wherever their account was located, which I
5 think was actually at PNC.

6 Or what typically occurs, and what could've occurred
7 here is that the two parties would've got on the phone and said
8 "I owe you dollars, you owe me euros, but on a net basis I owe
9 you six million dollars net, so just write me a check or send
10 me a wire for six million", in which case there would have been
11 no euros deposited in any account for the benefit of Neuberger.
12 But it was for the benefit of Neuberger. There is one
13 confirmation, it's between PNC and Neuberger. And that's what
14 would have occurred. And the only reason we're here is because
15 Neuberger went to Lehman on the date of settlement and
16 Neuberger, of course you recall, was owned by Lehman at the
17 time.

18 THE COURT: Yes. I presided at the sale hearing.

19 MR. BROSTERMAN: Right, I know. Okay, called up the
20 Lehman people and said, "You know, we don't want to find
21 ourselves in the middle of a bankruptcy dispute where Lehman
22 says they have a right to -- somehow a right to monies which
23 they should not have a right to because it's a Neuberger/PNC
24 trade, the confirmation is very clearly a Neuberger/PNC trade.
25 So will you agree to release us and allow us to do this? Just

1 tell us you're not going to make a claim and we would happily
2 wire the money, the net six million dollars, to PNC."

3 That didn't occur, and that's why within three -- two
4 weeks thereafter PNC sued. We then entered into -- Neuberger
5 entered into a settlement with PNC which simply says that if a
6 court finds that you are the one who is entitled to get this
7 money, you will receive interest on that at a prescribed rate.
8 So we fixed the rate of interest at least because, you know,
9 interest could have been fluctuating all over.

10 So the principal amount was never in dispute. And in
11 our view, who the beneficiary and the party to whom we owed the
12 money was never in dispute. But Lehman took until November
13 10th and then on November 10th said that they -- or asserted
14 that they have a claim. They have provided no confirmation of
15 any transactions which would support the notion that -- and we
16 dispute that, absolutely dispute that Neuberger entered into a
17 trade with Lehman as a principal to principal and that Lehman
18 entered into a trade with PNC.

19 Had that occurred, there would be a confirmation
20 between Lehman and PNC and there would be a confirmation
21 between Lehman and Neuberger. Whether they were the same or
22 different Lehman entities, that still would have occurred.
23 There are no such confirmations that we have ever seen, we have
24 ever received.

25 The confirmation that we are familiar with is the

1 confirmation that PNC sent to us confirming the trade which is
2 a PNC to Neuberger and the reference to Lehman is that since
3 our money is cleared through Lehman, they came into Lehman,
4 Neuberger's account at Lehman. The reference account to which
5 the monies were to be sent, it says Lehman, it doesn't even say
6 which Lehman entity, account number blankety-blank, reference
7 Neuberger Berman. And that's what the trade was.

8 And the issue -- let's assume they have a claim.
9 Let's assume they believe that in fact the contract is not as
10 I've described it but some other way, that Lehman entered into
11 a contract with PNC and that Lehman entered into a contract
12 with Neuberger Berman. Those issues, on one side or the other,
13 are still contract issues that can be resolved. They do not
14 require the unique expertise of this Court because they are
15 fundamentally contract issues that this Court or the federal
16 District Court sitting in the Western District of Pennsylvania
17 can address.

18 But our concern is that we want to be in one
19 jurisdiction. And we want to be in one jurisdiction without
20 the ability of PNC to proceed against us in the Western
21 District of Pennsylvania. And if the money is deposited here,
22 and our next motion is the motion for injunctive relief -- and
23 we would hope if Your Honor grants our motion to deposit the
24 funds, it would then grant subsequently -- it would then have
25 jurisdiction over this and could grant a subsequent motion

1 which we would file shortly after getting that order allowing
2 for the deposit, a motion for injunctive relief, then it is --
3 we are concerned that we will engender more fees if people
4 start challenging the juris -- not us, okay, but people start
5 challenging the jurisdiction of this Court to issue that
6 injunction.

7 And if the injunction doesn't stand up then we're
8 back to square one with this case pending and the case in the
9 Western District of Pennsylvania, assuming -- I don't mean to
10 be presumptuous, Your Honor, I'm just explaining -- laying out
11 the potential courses here if Your Honor were to issue the
12 injunction.

13 Whereas, if the case is transferred, since the Court
14 has a lighter docket and can move this case quickly, there will
15 be one or two proceedings there, we will have a trial, I'll fly
16 there, Ms. Bronson will fly there, but it's going to be --
17 because of the short time frame in which that court has
18 expressed that it will resolve this case, a very short time
19 frame. In fact, in April -- I mean, we would have had a trial
20 by now, long since, because that's -- the docket of the court
21 permits it.

22 We will all save a great deal of money. We will save
23 the money -- we will save the cost of having to make a
24 subsequent motion for an injunction. We will save the costs
25 associated with appeals on any injunctions that are granted or

1 not granted, we will save. So from our perspective -- and --
2 and we will be in one court and one court only.

3 THE COURT: Okay. I understand what you're saying.
4 Others are going to speak and it's getting late. I think what
5 I'm missing and what I'd like people to talk to before we get
6 into the merits of the motions that are in front of me -- and
7 these motions date back to July, if I recall.

8 MR. SLACK: They do, Your Honor.

9 THE COURT: It looks to me as if there isn't that
10 much to fight about -- and that's one of the things that I'm
11 having some difficulty understanding -- in terms of the merits
12 of this issue. Forget whether this is a court with a busy
13 docket and some other court may have more time, I'm always
14 available for trial time and it just means that I'm spending
15 less time in my chambers and more time here. It's all right,
16 I'm here anyway.

17 MR. BROSTERMAN: I'm aware of that, Your Honor.

18 THE COURT: So that's, I think, less the issue.
19 What's more the issue is why you can't resolve what seems to be
20 a relatively benign plain vanilla business issue. And I'm not
21 pointing fingers at anybody in saying this. It appears to me
22 from what I've read that probably to minimize future risk in
23 connection with currency fluctuation that there was, in effect,
24 a netting of the euro/dollar exchange as of the date in
25 February and that that's the amount in controversy.

1 MR. BROSTERMAN: Agreed.

2 THE COURT: That it's really just a question of who
3 gets that.

4 MR. BROSTERMAN: Agreed.

5 THE COURT: I don't understand what the legal issues
6 are on one side or the other as to who would have a claim and
7 why, because that's never been presented to me in a way that I
8 understand it.

9 MR. BROSTERMAN: Honestly, Judge, I don't have a clue
10 as to how Lehman could have a claim. And I can't answer your
11 question, I really can't.

12 THE COURT: Okay. I think we should -- frankly,
13 rather than argue about procedure and the risks of multiple
14 courts having jurisdiction and the risks that an Article I
15 court may or may not have appropriate power to issue
16 enforceable injunctions under a particular jurisdictional
17 section of 28 U.S.C..

18 It seems to me that this is, frankly, complicating
19 and making more expensive something that seems to me eminently
20 settle-able. Who's in the way here? Because whoever is in the
21 way, get out of the way. Is that you?

22 MS. BRONSON: No, Your Honor, it's not.

23 THE COURT: Okay.

24 MS. BRONSON: It's not the debtor. In effect, the
25 Lehman entities have an interest in the funds that Neuberger

1 Berman is currently holding, whether those be with Neuberger
2 Berman or deposited with the Court. So we have, as the debtor,
3 every right to make a claim to those funds. So --

4 THE COURT: What's the interest?

5 MS. BRONSON: What's our interest?

6 THE COURT: Yes.

7 MS. BRONSON: Based on the transaction that was
8 entered into by Neuberger Berman and Lehman -- I can walk you
9 through the procedural history if you would d like me to of
10 the --

11 THE COURT: I just want to know whether there's any
12 easy way out of this thicket.

13 MS. BRONSON: We believe we have a claim to the
14 funds. The Lehman entities believe they have a claim to the
15 funds.

16 THE COURT: To all the funds or --

17 MS. BRONSON: Neuberger --

18 THE COURT: To all the funds or a portion of the
19 funds?

20 MS. BRONSON: To the funds.

21 THE COURT: And why is that? What's the basis for
22 it?

23 MS. BRONSON: Because we were a principal on the
24 transaction as between Neuberger Berman and PNC, if you
25 envision the transaction as follows, Your Honor. PNC and

1 Neuberger agreed to exchange currency. PNC agreed to pay to
2 Neuberger Berman Europe 26.4 million Euros. And Neuberger
3 Berman agreed to pay PNC 40.2 million dollars. The trade was
4 effectuated through intermediary trades between Lehman. And
5 despite Mr. Brosterman's representations that there's no
6 documentation out there that would show that we were part of
7 the transaction or there's no confirmations, we, in fact,
8 believe that there are confirmations that will show that
9 there's a direct link between Neuberger Berman and the Lehman
10 entities as well as onto PNC.

11 THE COURT: You said something that was hedged. You
12 said "We, in fact, believe that" as opposed to "We have in our
13 possession and have seen and reviewed and can confirm to you
14 that".

15 MS. BRONSON: Oh, I've seen confirmations, Your
16 Honor -- I will make that representation to the Court -- that
17 ties the Lehman entities to Neuberger Berman with respect to
18 the specific trades that are at issue in this exchange of
19 currency.

20 So while we're here today on PNC's motion to dismiss,
21 we have obviously not done any discovery. No one's propounded
22 discovery on us. No one's provided us with any discovery to
23 say that we don't have an interest. We're here today to
24 determine whether or not the interpleader action should survive
25 the motion to dismiss.

1 And we believe, based on the fact that Lehman has
2 answered the complaint and said we do have a claim to the
3 money, and the fact that PNC has also filed, one, a claim
4 against Neuberger Berman in the Western District of
5 Pennsylvania as well as a proof of claim against LBCC in this
6 bankruptcy, that there is definitely a dispute as to who
7 rightfully has an interest in those funds.

8 THE COURT: Well, let me understand something that's
9 very, very simple. Is there a dispute as to the net amount
10 due? In other words, does everybody agree that if you net
11 euros and dollars as of a date in February, you get a certain
12 amount of money which is the money that Neuberger Berman
13 intends to pay into the registry of the Court?

14 MS. BRONSON: Your Honor, I wasn't part of the
15 negotiation as between PNC and Neuberger.

16 MR. BROSTERMAN: It's not a negotiation. If -- it's
17 not a negotiation at all. It's simple math. The confirmation
18 between PNC and Neuberger has a rate in it. If you take a
19 calculator and you multiply the rate by the number of dollars
20 and the number of euros you come up with an amount. So it's
21 not a negotiation at all, Your Honor. It is simple math based
22 upon the documentation.

23 THE COURT: Okay. Well, here's what I'm completely
24 missing, quite beyond procedure. If it's simple math -- and I
25 suspect that at the time this transaction was entered into it

1 was always assumed that there would be a netting and a payment
2 as opposed to an actual transfer of euros and dollars, so that
3 in the real world of finance it would net. So there is a net
4 amount due. Is there a dispute that the net amount is due to
5 PNC?

6 MS. BRONSON: We have a dispute with respect to that.
7 We don't believe --

8 THE COURT: What on earth could that be based on?
9 If --

10 MS. BRONSON: We were a principal on the transaction.
11 The money should come through our estate as opposed to going
12 directly to PNC.

13 THE COURT: Is this about an override? Is this about
14 a commission? What is this about? How could the monies ever
15 stick with you if the money is due and owing to PNC?

16 MS. BRONSON: If PNC has a claim against us, as they
17 have asserted in their proof of claim, they can make a claim
18 against --

19 THE COURT: But it was a protective --

20 MS. BRONSON: -- the bankruptcy estate.

21 THE COURT: -- proof of claim that was filed because
22 this whole thing has taken so long and because a proof of claim
23 bar date in September came up, so they filed their proof of
24 claim. If it had been resolved in July, there would have been
25 no proof of claim. So I don't understand, in a principled way,

1 how Lehman can be arguing that PNC's money somehow belongs to
2 you. What's the basis for that?

3 MR. SLACK: Your Honor, can I take a shot at this?

4 THE COURT: Yeah. Take a shot at it, because
5 frankly, it's late in the day and I'm getting a very strong
6 sense that Lehman is acting unreasonably in this setting.

7 MR. SLACK: Well, it's not the case, Your Honor. I
8 think --

9 THE COURT: I'm sure it's not the case.

10 MR. SLACK: I --

11 THE COURT: It's the sense I have.

12 MR. SLACK: Right.

13 THE COURT: And since it's a long day and it's been a
14 long week, you have a long way to go to convince me that you're
15 right.

16 MR. SLACK: Okay, fair enough. Here's what I -- I
17 want to be unequivocal. It sounds like the other parties don't
18 have the confirmations we have. We have contracts,
19 confirmations that tie the money from Neuberger to Lehman and
20 Lehman to PNC. They were an intermediary. It sounds like Mr.
21 Brosterman doesn't have the confirmations we do.

22 MR. BROSTERMAN: Your Honor --

23 MR. SLACK: Let me just --

24 MR. BROSTERMAN: If Your Honor will simply direct
25 them to give them to me --

1 THE COURT: Just one sec. I just want to hear
2 what --

3 MR. BROSTERMAN: Sure.

4 THE COURT: I want to hear what Mr. Slack has to say
5 to make me more comfortable with his position.

6 MR. BROSTERMAN: Okay.

7 MR. SLACK: And so this is purely a matter of
8 contract. And Your Honor, what this contract says is that --
9 and it's for the exact same amount, everything ties out, Your
10 Honor, so that the money that went from Neuberger, it flowed
11 through Lehman and from Lehman it was going to PNC.

12 So we can say that PNC made a protective proof of
13 claim, but we believe that when Your Honor actually looks at
14 the confirmations, as now we've had the opportunity to do --
15 and it's not a "We believe that there are confirmations", there
16 are in fact confirmations -- that Your Honor will see that that
17 money belongs to Lehman, the Lehman estate.

18 And what PNC has is in fact what they've done, they
19 have a claim against the Lehman estate for the six million.
20 And what it comes down to, Your Honor, is that the Lehman
21 estate should be paid actual dollars, six million, and PNC will
22 get a claim for six million dollars.

23 And that's what this dispute, frankly, is about, is
24 that Lehman is actually entitled to the cash and PNC is
25 entitled to a claim for it through. And that is -- you know,

1 there are, Your Honor, as you have probably heard in a number
2 of hearings, a number of back-to-back trades where this is not
3 a unique situation where there are back-to-back trades, and
4 this is one of those situations.

5 So I just want to be very direct that we do have the
6 confirmations that tie this through and we believe that when
7 Your Honor looks at them you'll agree with us that the Lehman
8 estate is entitled to the money.

9 THE COURT: Okay. Now, here's a question that I
10 have, and this goes to, I guess, the confirmations. The
11 confirmations presumably -- and I'm making this up -- deal not
12 with the netting that we're talking about but rather with the
13 full notional amount of the euros and the full notional amount
14 of the dollars.

15 MR. SLACK: Yes. All the -- and I think I understand
16 your -- if I understand your question, they are in fact all
17 back-to-back, so they're all identical confirmations so that,
18 in other words, the trade that Neuberger has with Lehman is the
19 same then that Lehman has with PNC.

20 THE COURT: And was this at LBI or was this at LBHI
21 or which -- where was it?

22 MR. SLACK: So the -- I think the original trade,
23 Your Honor, was between Neuberger and LBI, and LBI and LBCC had
24 a back-to-back trade. You know, how that's characterized in
25 terms of whether it's its principal or agent, that's a whole

1 other issue, Your Honor, which is why what's happening is that
2 the debtors themselves have spent some time, we have agreed to
3 our own sort of accommodation in this regard so that we can
4 unify the interests of Lehman which has taken some time. So
5 that what you're going to be able to hear, Your Honor, is
6 you'll see the trail but there won't be any question as to
7 who's entitled to the money.

8 THE COURT: Okay. What's the LBI position here?

9 MR. GREILSHEIMER: The LBI position, Your Honor --
10 Jeff Greilsheimer with Hughes Hubbard -- is we would agree in
11 principal with LBCC to assign whatever interests we have here
12 to them in exchange for a release of whatever claim they have
13 against us and with them indemnifying us and to get us out of
14 this mess.

15 THE COURT: Okay. Based upon what I've heard, I
16 think it's going to be very difficult for there to be a change
17 of venue to the Western District of Pennsylvania even if it is
18 cheaper to stay there in nice hotels.

19 The representations that have been made -- which are
20 just that, representations, there's no evidence in this
21 hearing -- deal with a relationship in which there were
22 complicated internal, at the time, undertakings in which
23 Neuberger Berman, then part of the Lehman organization,
24 evidently confirmed these currency trading arrangements with
25 both LBCC and LBI, presumably for the ultimate benefit --

1 although it's not looking that way right now -- of PNC. And
2 given that representation, and subject to discovery that might
3 be taken to confirm all of this, absent some agreement
4 acceptable to the parties, this looks like a litigation
5 that's going to have to go on track here as an adversary
6 proceeding.

7 Now, in terms of the baseline motion brought by
8 Neuberger Berman, now as an independent entity through Stroock,
9 to take funds that it controls and to deposit those funds here
10 for safekeeping, is there any opposition to that? I thought
11 that that was mostly consensual.

12 MS. BRONSON: No opposition, Your Honor.

13 MR. YORSZ: Stanley Yorsz for PNC, Your Honor. We do
14 object to that, primarily because we do not think that there
15 was a jurisdiction in the bankruptcy court that can issue --

16 THE COURT: Well, I'm now convinced, based upon what
17 I've been told, that there is at least a pretty good claim to
18 be made that jurisdiction belongs here, (a) because you did
19 file a protective proof of claim; (b) because debtors' counsel
20 confirms the existence of trade confirmations which I presume
21 you can obtain copies of through either formal discovery or
22 making a request or asking for it right now; and (c) LBI, which
23 appears to have been involved in this, also independently
24 confirms that they're, in effect, transferring whatever rights
25 LBI might have -- and apparently they're part of the chain as

1 well -- in exchange for release to LBCC, all of which suggests
2 to me that this is a matter that a district judge in Pittsburgh,
3 or for that matter most anywhere else, would not be anxious to
4 handle, and more importantly, would not have jurisdiction to
5 handle, because this is, as represented -- I'm not saying that
6 the facts may not be presented differently after discovery -- a
7 situation that involves property of the estate or assets that
8 may be property of the estate.

9 So as to the deposit of monies into the registry of
10 the Court now, for purposes of interpleader, are you still
11 pressing an objection?

12 MR. YORSZ: I am, Your Honor. Could I speak just
13 briefly on two things?

14 THE COURT: Sure.

15 MR. YORSZ: I realize it's been a long day and a long
16 week. It's been a long eight or nine months for PNC while we
17 have tried to get some kind of resolution of this matter and
18 some type of statement from LBCC with regard to what their
19 claim is.

20 And I have to say, I'm distressed after the last time
21 we were before Your Honor and you urged us to try to get
22 together to settle this, and suddenly we find these documents
23 have appeared that provide them some type of claim when perhaps
24 if instead of presenting that suggestion at this hearing we had
25 gotten on the phone and discussed it. So that distresses me

1 from the point of view of trying to get this settled without
2 the involvement of the Court now or in the future.

3 But with regard to the protective filing, Your Honor
4 was correct. We had no choice but to file. We had the bar
5 date coming up. We had believed, obviously incorrectly now,
6 that we were moving towards settlement in the summer. And so,
7 frankly, perhaps I should have come up to Your Honor much
8 sooner and tried to insist that LBCC file their response. Or
9 perhaps I should have gone to the Western District and filed a
10 summary judgment motion at that time.

11 I didn't do that because PNC was trying to save
12 everyone time and effort in getting this resolved. And now we
13 find that because we did wait we're being pillared for filing
14 the protective proof of claim. And we just didn't have any
15 choice, given the time frame that we were in.

16 THE COURT: Well, you're in bankruptcy court now, as
17 to that there is no doubt. And there's also no doubt that
18 there are issues of fact that may be simple enough to develop
19 with cooperative action or through focused discovery, but there
20 are issues of fact concerning the involvement of Lehman
21 entities in structuring and/or facilitating this trade.

22 So I hear your objection to the turnover of the
23 funds, but I think under the circumstances, the only proper
24 place for the funds to be held, unless there is some agreement
25 to hold them in a attorney's escrow account or in some

1 segregated account in a financial institution acceptable to all
2 the parties, the funds can be deposited and I think should be
3 deposited into the court's registry unless there's another
4 agreement reached.

5 So the interpleader motion made by Neuberger Berman
6 concerning the funds held by Neuberger Berman is granted. The
7 objections of PNC to that turnover of the funds are overruled.

8 As to the transfer of the case to the Western
9 District of Pennsylvania, I deny that without prejudice based
10 upon the representations that have been made concerning the
11 nexus that this all has to the Lehman estate, and frankly, the
12 surprising revelation to me -- given that we've had multiple
13 pre-trial conferences, this is really the first time I've
14 learned any facts -- that there is a claim being made by Lehman
15 to the funds and that the funds need to be directed through
16 Lehman. Whether or not that's true needs to be developed. And
17 I suspect that will be a matter for future litigation, either
18 at an evidentiary hearing or, if there's an agreement
19 concerning facts, a hearing on motion for summary judgment.

20 The nature of this transaction may also have been
21 modified by the parties' agreement to enter into a netting
22 arrangement which has been described on the record. I do not
23 know, since I haven't read the documents in connection with
24 that netting, whether or not Lehman may have waived rights or
25 whether there are rights of Lehman that may have been affected

1 by the netting arrangement. That's something which presumably
2 others will tell me about, if relevant.

3 That's my disposition of this for now.

4 MR. BROSTERMAN: Your Honor, with the Court's
5 permission, if PNC -- and I realize Mr. Yorsz has to go back to
6 his client -- will not agree to stay its proceeding or its
7 activities in the Western District of Pennsylvania, we would
8 have to come to this Court on a fairly expedited basis seeking
9 injunctive relief under --

10 THE COURT: 1335?

11 MR. BROSTERMAN: -- 28 U.S.C. 1335, yes.

12 THE COURT: Okay.

13 MR. BROSTERMAN: Okay? And we ask in open court for
14 copies of the confirmations because we'd be fascinated to see
15 them. And I would hope since I've given them everything I have
16 without a formal discovery request, that I don't have to make a
17 formal discovery request to have that courtesy extended to me
18 as well.

19 MR. SLACK: Your Honor, what I was going to say --
20 and I think this will answer that question -- is we've had to
21 address sort of the internal Lehman issues and that has taken
22 some time, and we have strong hopes that upon sharing the
23 information that we have that the parties can actually sit down
24 and try to resolve this. So we certainly are willing to
25 provide what we think are the key documents and sit down and

1 talk and try to resolve this.

2 THE COURT: Fine. To the extent that there are any
3 statements that are on the record to this point that are in the
4 nature of factual determinations, it should be clearly
5 understood that this is simply a preliminary assessment based
6 upon representations of counsel of what the facts appear to be,
7 and everything is subject to proof at a later time at an
8 evidentiary hearing or by stipulation of the parties.

9 I think this concludes the agenda for the evening. I
10 will need orders in connection with the matters that are now
11 before me. One would be an order denying the requested
12 transfer to the Western District without prejudice. The
13 other would be an order in connection with the deposit of the
14 funds.

15 MR. BROSTERMAN: There is -- and if the Court would
16 like, there is attached to our moving papers on the motion an
17 order, but we will deliver an order to chambers.

18 THE COURT: I don't think you're going to want me
19 searching for what you originally filed

20 MR. BROSTERMAN: I'm not.

21 THE COURT: -- in your moving papers.

22 MR. BROSTERMAN: That's why I --

23 MR. YORSZ: Your Honor, I --

24 MR. BROSTERMAN: -- updated my sentence the way I
25 did, Your Honor.

1 MR. YORSZ: -- with regard to the deposit in the
2 court, I believe Your Honor said that if the parties can agree
3 on something else acceptable to them, that is --

4 THE COURT: That is absolutely acceptable. Whatever
5 the parties consider appropriate is appropriate from my
6 perspective as long as the funds are secure. We're adjourned.

7 MR. YORSZ: Thank you.

8 ALL: Thank you, Your Honor.

9 (Whereupon these proceedings were concluded at 5:37 p.m.)
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I N D E X

R U L I N G S

DESCRIPTION	PAGE	LINE
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concerning the funds held by Neuberger Berman		
granted		
Motion to transfer the case to the Western	126	8
District of Pennsylvania denied without prejudice		

C E R T I F I C A T I O N

I, Lisa Bar-Leib, certify that the foregoing transcript is a
true and accurate record of the proceedings.

LISA BAR-LEIB

AAERT Certified Electronic Transcriber (CET**D-486)

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Date: November 22, 2009